

Frutarom Industries Ltd.
Directors' Report to the Shareholders
for the Period Ending June 30, 2004

Frutarom Industries Ltd. ("Frutarom" or "the Company"), founded in 1933, is a multinational firm that became a public company in 1996. Frutarom develops, produces and markets flavors, flavor and fragrance ingredients, and medicinal plant extracts and has significant manufacturing and development centers on three continents at which more than 800 people are employed. Frutarom markets its products in over 85 countries worldwide.

Frutarom achieved impressive results in the second quarter of 2004, continuing its positive trend for the 19th consecutive quarter. The Company's two divisions, the Flavors and Fine Ingredients Divisions, continued to increase their sales, margins, and profit while improving product mix. Continued accelerated organic growth is a central element in the ongoing implementation of Frutarom's strategy, which combines robust internal growth with acquisitions bringing knowhow and additional activities, as well as expanding Frutarom's core business activities within its strategic geographical markets.

Similar to the first quarter, during the second quarter the results of the successful integration of the Swiss company Emil Flachsmann AG ("Flachsmann"), purchased in June 2003, had a positive influence. The integration of the two companies' activities has created a synergetic relationship that leverages each of the companies' inherent and complementary strengths and which is expected to achieve even greater benefits in the future. Collaboration between research and development teams is leveraging both companies' knowledge base and driving the development of new and innovative products. Operations and production staff are working diligently to increase efficiency and better utilize production capacity. Marketing and sales organizations have been unified, making the most out of Frutarom's and Flachsmann's relative advantages. The Frutarom Group customer base has expanded and many new customers have been added, including market leaders in the food and pharmaceutical segments. This integration of activities and the synergy between the firms has achieved considerable cost savings, contributing to Frutarom's first and second quarter results. The Flachsmann acquisition has strengthened the Frutarom Group's managerial, research and development, operational, and sales and

marketing infrastructures, which today are prepared for additional strategic acquisitions and their subsequent efficient integration with the Frutarom Group as a whole, in accordance with the Company's strategy.

On May 27, 2004, Frutarom signed a letter of intent with International Flavors & Fragrances Inc. ("IFF") to acquire IFF's Fruit Preparation business in Europe, which had a sales turnover of US\$ 90 million in 2003. The Fruit Preparation business develops and produces unique fruit and other natural compounds that are used as natural flavor materials in a wide range of food products such as dairy, bakery, and others. According to the letter of intent, in the first stage the activities and assets of IFF's Fruit Preparation business in Switzerland and Germany will be purchased and integrated into Frutarom's existing activities in those countries. The second stage will involve the acquisition of IFF's Fruit Preparation business in France, following the completion of IFF's consultation process with the French works council (regarding the potential sale of the business to Frutarom and the closure of the French site, at which other IFF activities are also located). The Fruit Preparation business in France constitutes 30% of IFF's fruit preparation business in Europe. Upon completing the acquisition of the French business, its manufacturing activity will be integrated with the existing plants in Germany and Switzerland to achieve optimal synergy, savings and efficiency. The application laboratories and sales and marketing activities, which are dedicated to the French market, will remain in France, where Frutarom expects to significantly expand its activity.

Completing the acquisition of IFF's Fruit Preparations business in Europe will constitute an additional step in realizing and implementing the Frutarom Group's rapid growth strategy. The acquisition dovetails well and is synergetic with Frutarom's existing activities and capabilities in the fields of natural flavors, plant extracts, functional foods and nutraceuticals. Frutarom intends to use this acquisition to leverage and strengthen its position as a leading supplier of natural flavor materials offering leading food manufacturers comprehensive natural solutions, including a wide and innovative range of products for the functional foods industry. The acquired activity is also expected to consolidate Frutarom's activity in the savory field. The products, customers and geographic spread of IFF's Fruit Preparation business are complementary to Frutarom's activities, allowing Frutarom to extract the considerable synergy between its activities while unifying management, research and development, operations and sales and marketing infrastructures.

Frutarom continues its rapid organic growth by consolidating and expanding its core activities. Accordingly, it is establishing two additional subsidiaries and development laboratories in Romania and Belarus. These new subsidiaries will employ experienced local sales and marketing and development personnel who are familiar with their markets. The new companies are expected to contribute to strengthening Frutarom's presence in high growth emerging markets. Frutarom regards the establishment of additional subsidiaries and the expansion of its development, sales and marketing infrastructures in Eastern Europe as an important factor in implementing its business strategy.

The Flavors Division, which is the more profitable of Frutarom's activities, continued to show the same rapid growth in the second quarter of 2004, with impressive performance by most of its subsidiaries worldwide. In the UK, accelerated growth was sustained, with an increased performance in emerging markets such as Russia, Ukraine, Kazakhstan and China, countries where the growth rate of processed foods consumption is higher than the global average. These factors contributed to Frutarom's continued growth in margins, and are expected to continue to play a significant role in the Company's long term development.

Frutarom's sales in the second quarter of 2004 totaled US\$ 44.6 million (NIS 202.9 million), a 38.0% increase compared with the same period in 2003. Gross profit rose 44.2%, amounting to US\$ 15.6 million (NIS 71.1 million) compared with US\$ 10.8 million (NIS 47.4 million) during the same period in 2003, while the gross margin rose from 33.6% to 35.1%. Operating profit increased 55.1% to US\$ 6.6 million (NIS 29.8 million) compared with US\$ 4.2 million (NIS 18.5 million) in the second quarter of 2003. Net profit rose by 73.7%, reaching US\$ 5.1 million (NIS 23.0 million), compared with approximately US\$ 2.9 million (NIS 12.7 million) in the second quarter of 2003. Net margin also rose to 11.3% compared with 9% in the same period the previous year. Together with this increase in activity, Frutarom achieved a positive cash flow from current activities of US\$ 4.7 million (NIS 21.3 million) in the second quarter of 2004 compared with US\$ 2.8 million (NIS 12.1 million) during the same quarter last year.

Frutarom's sales for the first half of 2004 totaled US\$ 88.5 million (NIS 399.0 million), a 46.3% increase compared with the same period in 2003, when sales totaled US\$ 66.5 million (NIS 264.8 million). Gross profit for the period rose 54.1%, amounting to US\$ 30.5 million (NIS 137.6 million) compared with US\$ 19.8 million (NIS 86.7 million) in the same

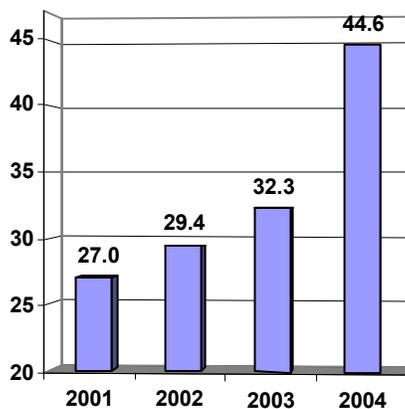
period in 2003, while the gross margin rose from 32.7% for the first half of 2003 to 34.5% for the same period in 2004. Operating profit increased 66.0% to US\$ 12.3 million (NIS 55.4 million) compared with US\$ 7.4 million (NIS 32.4 million) during the same period in 2004. Net profit rose by 90.6% to total US\$ 9.3 million (NIS 42.0 million) compared with approximately US\$ 4.9 million (NIS 21.4 million) in the same period in 2003. Net margin also rose, to 10.5% compared with 8.1% in the same period in 2003. Together with this surge in activity, in the first half of 2004 Frutarom achieved a positive cash flow from current activities that amounted to US\$ 8.4 million (NIS 37.7 million) compared with US\$ 2.5 million (NIS 11.0 million) during the same period in 2003.

The Company's equity capital as at June 30, 2004 amounted to US\$ 68.0 million (NIS 306.0 million) compared with US\$ 43.0 million (NIS 188.3 million) on June 30, 2003.

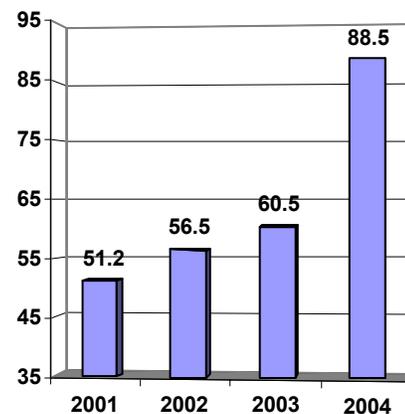
The growth in net profit in recent years is a result of, among others, the sustained rapid growth trend in Frutarom's activities, both through organic growth of core activities in both the Flavors and Fine Ingredients Divisions and through the successful integration of acquired businesses. The Company's continued improvement to product mix while achieving steady growth in the Flavors Division's portion of the Company's overall activity has also contributed to the growth in net profit. The improvement to product mix and growth in net profit also derives from the Fine Ingredients Division's focus on developing and introducing new products with comparatively higher than average margin. While expanding its activity in recent years, the Company has aimed to keep close control over expenses, which has also contributed to the growth in profit and margins achieved in recent years.

Sales Development (US\$ million)

Second Quarter: 2001–2004



First Half: 2001–2004



Frutarom invests considerable effort in continuing to implement the rapid growth strategy successfully implemented in recent years, which combines the strong organic growth of more profitable core activities with strategic acquisitions of companies, knowhow and activities in the Company's field of operations, with a view to becoming one of the ten global leaders in the flavor and fragrance industry.

I. **Brief Description of the Company and its Business Environment**

Frutarom's Flavors Division develops, produces and markets flavors and seasoning compounds intended for the food and beverage industries. The Fine Ingredients Division develops, produces and markets raw materials intended for producing flavors and fragrances, as well as developing, producing and marketing plant extracts and natural ingredients used in the flavor, fragrance, pharmaceutical, health food, functional food, nutraceutical and cosmetic industries. The Fine Ingredients Division is also involved in developing, producing and marketing building blocks in the peptide field, for use in the pharmaceutical industry in producing medicines using biotechnological methods. Through its subsidiary, Frutarom Trade & Marketing (1990) Ltd., Frutarom imports and markets various raw materials that the Company itself does not produce to customers in Israel.

Frutarom's products are produced in its plants in Israel, the United States, Switzerland, the United Kingdom, Denmark, Turkey, and China, and are sold to over 85 countries on five continents. Frutarom's international marketing infrastructure includes branches in Israel, the United States, Switzerland, the United Kingdom, Germany, Denmark, France, Romania, Russia, Ukraine, Kazakhstan, Belarus, Turkey, Brazil, Mexico, China, Hong Kong, and India. The Company also works through local agents and distributors worldwide.

Combining medicinal plants with food and beverages to create functional foods is a developing global trend. Frutarom enjoys a clear competitive advantage in this market due to the Company's proven ability in the extraction of medicinal plants and in the field of natural flavors for food. These two fields of expertise combine Frutarom's capabilities and rich experience in carrying out clinical studies and in developing, producing and using active ingredients from medicinal plants in food products. Frutarom's access and status as an approved supplier to leading global

food manufacturers are an added advantage, placing the Company in an excellent position to be a prominent supplier in the functional food segment and achieving a significant competitive advantage and differentiation, which it seeks to leverage.

II. Results of Activities

Frutarom's sales during the second quarter of 2004 totaled US\$ 44.6 million, an increase of 38.0% compared with US\$ 32.3 million during the same quarter in 2003.

The following contributed to the growth in sales:

- A. The successful merger of the Swiss company, Flachsmann, and its subsidiaries in Germany, Denmark and Canada with Frutarom. Flachsmann's activity considerably expanded Frutarom's product offerings and geographical markets (Flachsmann had a significant presence in Western Europe, Scandinavia, Japan, and Korea). Frutarom continues working diligently to fulfill and extract the considerable synergies inherent in the complementary Flachsmann and Frutarom businesses.
- B. The continued accelerated growth in recent years in the Flavors Division, which is the more profitable of Frutarom's activities. This growth was driven by strengthening the activity of Frutarom's subsidiaries throughout the world. During the first half of 2004, for the first time, over 50% of the Frutarom Group's total activity came from the Flavors Division. Frutarom expects to continue to invest in and strengthen all of the Flavors Division's sites in coming years, and regards this Division as a central element of its business development strategy for the future.
- C. Growth of the Fine Ingredients Division's sales, with the contribution of new products developed by Frutarom's research and development laboratories. These new products have on average higher margins in markets in which Frutarom has a competitive advantage.

- D. Continued consolidation and strengthening of Frutarom's global research, development, sales and marketing network. This includes the emerging market regions where Frutarom has recently begun its activities and where the growth of processed foods consumption is significantly higher than the global average.

Breakdown of Sales by Activity 1999–2004

Segment	1999	2000	2001	2002	2003	Jan. – June 2004
Flavors Division	28.4%	32.4%	38.8%	42.3%	48.8%	51.4%
Fine Ingredients Division	62.8%	59.8%	55.6%	52%	46.7%	44.5%
Trade & Marketing	8.8%	7.8%	5.6%	5.7%	4.5%	4.1%

Frutarom's gross profit rose 44.2% during the second quarter of 2004 to US\$ 15.6 million compared with US\$ 10.8 million during the second quarter of 2003. The gross margin also rose from 33.6% to 35.1% over the same period.

Selling, administration and general expenses for the second quarter of 2004 totaled US\$ 9.1 million, compared with US\$ 6.6 million during the same quarter in 2003. The increase in expenses is mainly a result of the merger of the Flachsmann Group's activity and the overall growth in the Frutarom Group's activities.

Operating profit for the second quarter of 2004 continued the upward trend of past years to reach US\$ 6.6 million, growing 55.1% compared with the second quarter of 2003. In parallel with the rise in operating profit, operating margin continued to growth, reaching 14.7% in the second quarter of 2004 compared with 13.1% for the same period in 2003.

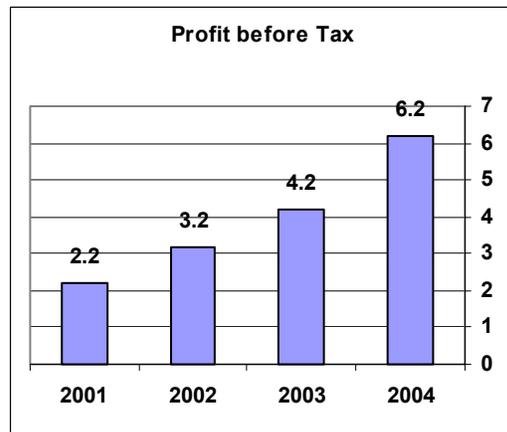
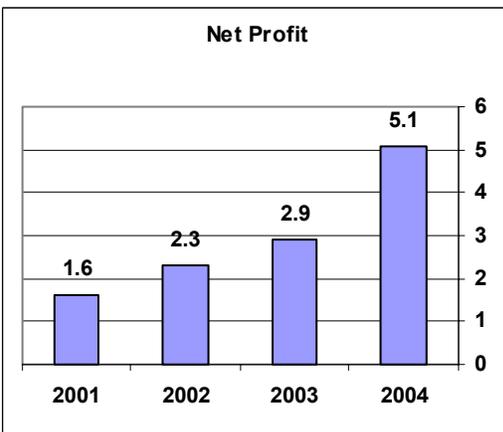
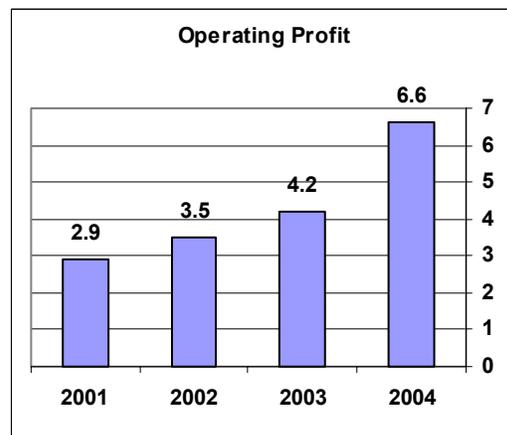
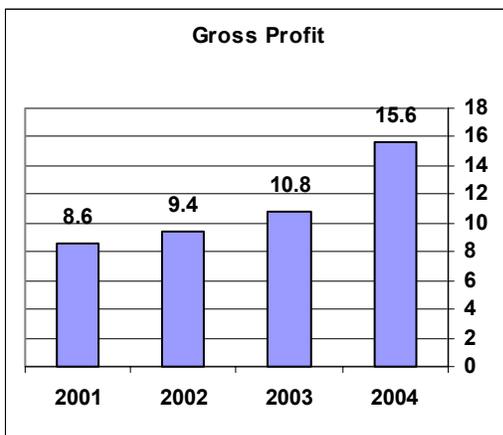
Finance expenses for the second quarter of 2004 totaled US\$ 0.4 million, compared with US\$ 0.1 million in the same quarter last year. The growth in finance expenses was due to exchange rate differences of non-US currency balances, which reduced finance expenses during the same quarter in 2003.

Profit before tax for the second quarter of 2004 rose 49.9% to US\$ 6.3 million compared with US\$ 4.2 million during the second quarter of 2003.

Tax expenses for the second quarter of 2004 totaled US\$ 1.2 million compared with US\$ 1.3 million in the same quarter of 2003. The growth in the profits of subsidiaries located in countries with a lower than average tax rate contributed to the decrease in the Company's tax rate.

Net profit for the second quarter grew 73.7% to US\$ 5.1 million compared with US\$ 2.9 million during the second quarter of 2003. The net profit margin also increased, reaching 11.3% compared with 9% during the second quarter of 2003.

Profit Development – Second Quarters 2001–2004 (US\$ million)



III. Financial Status

Total assets at June 30, 2004 amounted to US\$ 146.0 million, compared with US\$ 148.6 million at June 30, 2003.

The Company's current assets totaled US\$ 78.5 million compared with US\$ 78.0 million at the end of the same quarter last year.

Net fixed and other assets totaled US\$ 65.0 million on June 30, 2004 compared with US\$ 68.3 million at the end of the same quarter in 2003.

IV. Liquidity

During the second quarter of 2004, cash flow from operating activity reached US\$ 4.7 million compared with a cash flow of US\$ 2.8 million during the same quarter last year. The cash flow generated during the quarter was used to reduce debt, to pay a dividend to the shareholders and for investments made by the Company.

V. Sources of Finance

A. Equity

The Company's equity as at June 30, 2004 totaled US\$ 68.0 million (46.6% of the total balance sheet). The increase in the Company's equity during the second quarter resulted from the Company's profit for the quarter in the amount of US\$ 5.1 million.

B. Long Term Loans Including Current Maturities of Long Term Loans (Quarterly Average)

The average long term credit from banks totaled US\$ 36.4 million. During the same quarter last year, the Company had long term credit of US\$ 32.9 million at its disposal.

C. Short Term Loans Excluding Current Maturities of Long Term Loans (Quarterly Average)

The average short term credit from banks totaled US\$ 1.8 million. During the same quarter last year, the Company had short term credit of US\$ 7.5 million at its disposal.

D. Credit From Suppliers and Customers (Quarterly Average)

The average credit from suppliers and other creditors was US\$ 34.7 million (US\$ 26.4 million during the same period in 2003). During the second quarter of 2004, Frutarom granted average credit of US\$ 34.2 million to receivables (US\$ 28.9 million during the same period in 2003).

VI. Disclosures about Market Risk

No significant events or changes have occurred in the Company's exposure to market risk compared with December 31, 2003, as presented in the Directors Report of that date.

VII. External Influences

There have not been any changes since the Directors Report issued for the period January to December 2003 as stated in the Directors Report as at December 31, 2003.

VIII. Events Following the Balance Sheet Date

There were no significant events following the balance sheet date.

The Board of Directors of the Company held two meetings during the period under report.

The Board of Directors thanks Frutarom's employees and management for the Company's handsome achievements.

Dr. John J. Farber
Chairman of the Board

Ori Yehudai
President & CEO
Member of the Board

August 11, 2004