

**FRUTAROM INDUSTRIES LTD.**

INTERIM REPORT

(Unaudited)

AT SEPTEMBER 30, 2004

**FRUTAROM INDUSTRIES LTD.**

INTERIM REPORT

(Unaudited)

AT SEPTEMBER 30, 2004

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....., 2004

The Board of Directors  
Frutarom Industries Ltd.  
Haifa

Re: Review of condensed consolidated unaudited interim financial statements  
for the nine and three-month periods ended September 30, 2004

At your request, we have reviewed the condensed consolidated interim balance sheet of Frutarom Industries Ltd. (hereafter - the company) and its subsidiaries at September 30, 2004 and the condensed consolidated statements of income, changes in shareholders' equity and cash flows for the nine and three-month periods ended on that date.

Our review was performed in accordance with the procedures prescribed by the Institute of Certified Public Accountants in Israel. Inter alia, these procedures included: reading of the aforementioned financial statements, reading of minutes of meetings of shareholders, the board of directors and its committees, and making inquiries of company officers responsible for financial and accounting matters.

We were furnished with the reports of other auditors who reviewed the condensed interim statements of consolidated subsidiaries, whose assets constitute approximately 4% of the total consolidated assets as of September 30, 2004, and whose turnover included in consolidation constitutes approximately 11.1% and 10.6% of the total consolidated turnover included in the condensed statements of income for the nine and three-month periods ended on that date, respectively.

Since our review was limited in scope and did not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the condensed consolidated interim financial statements.

In performing our review, including the perusal of the reports of other auditors referred to above, nothing came to our attention that indicates that material adjustments need to be made to the interim condensed consolidated financial statements referred to above in order for them to be considered as having been prepared in accordance with accounting principles generally accepted in Israel and with the Israeli Securities Regulations (Periodic and Immediate Reports), 1970.

Sincerely,

**FRUTAROM INDUSTRIES LTD.**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
**AT SEPTEMBER 30, 2004**

	<b>September 30</b>		<b>December 31</b>
	<b>2004*</b>	<b>2003</b>	<b>2003**</b>
	<b>U.S. dollars in thousands (note 1c)</b>		
	<b>(Unaudited)</b>	<b>(Audited)</b>	
<b>A s s e t s</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	7,243	5,674	5,092
Accounts receivable:			
Trade	40,986	33,452	29,532
Other	9,956	6,396	5,830
Inventories	36,452	31,729	32,581
T o t a l current assets	94,637	77,251	73,035
<b>LONG-TERM RECEIVABLE</b>	2,492	2,455	2,643
<b>NON-CURRENT ASSETS:</b>			
Cost	109,914	83,103	83,005
Less – accumulated depreciation	29,993	24,374	25,876
	79,921	58,729	57,129
<b>OTHER ASSETS</b> , net of accumulated amortization	17,882	9,000	9,334
T o t a l assets	194,932	147,435	142,141

\_\_\_\_\_) President, Business Manager  
Ori Yehudai ) and Member of the Board  
\_\_\_\_\_) of Directors

\_\_\_\_\_) Executive Vice President  
Alon Granot ) and CFO

Date of approval of the financial statements:  
November 14, 2004

	<u>September 30</u>		<u>December 31</u>
	<u>2004*</u>	<u>2003</u>	<u>2003**</u>
	<u>U.S. dollars in thousands (note 1c)</u>		
	<u>(Unaudited)</u>		<u>(Audited)</u>
<b>Liabilities and shareholders' equity</b>			
<b>CURRENT LIABILITIES:</b>			
Bank credit	43,647	8,541	9,103
Accounts payable:			
Trade	18,178	15,795	14,355
Other	<u>23,649</u>	<u>20,607</u>	<u>17,527</u>
T o t a l current liabilities	<u>85,474</u>	<u>44,943</u>	<u>40,985</u>
<b>NON-CURRENT LIABILITIES:</b>			
Deferred income taxes	3,974	6,580	4,424
Liability for employee rights upon retirement, net of amount funded	7,048	980	1,232
Bank loans	25,193	36,251	33,700
Other non-current liabilities	<u>          </u>	<u>1,141</u>	<u>1,217</u>
T o t a l non-current liabilities	<u>36,215</u>	<u>44,952</u>	<u>40,573</u>
T o t a l liabilities	121,689	89,895	81,558
<b>SHAREHOLDERS' EQUITY:</b>	<u>73,243</u>	<u>57,540</u>	<u>60,583</u>
	<u>194,932</u>	<u>147,435</u>	<u>142,141</u>

\* See note 3.

\*\* See note 4.

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

**FRUTAROM INDUSTRIES LTD.**

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE NINE-MONTH AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2004

	9 months ended June 30		3 months ended June 30		Year ended December 31
	*2004	2003	*2004	2003	*2003
	(Unaudited)		(Unaudited)		(Audited)
	In thousands				
SALES	139,848	102,851	51,362	42,373	143,676
COST OF SALES	92,409	69,626	34,432	28,942	97,267
GROSS PROFIT	47,439	33,225	16,930	13,431	46,409
SELLING AND MARKETING EXPENSES	17,564	13,830	6,150	5,850	21,013
ADMINISTRATIVE AND GENERAL EXPENSES	10,729	8,054	3,926	3,644	11,693
INCOME FROM ORDINARY OPERATIONS	19,146	11,341	6,854	3,937	13,703
FINANCIAL EXPENSES - net	797	686	350	284	1,073
OTHER INCOME – net	153	50	22	21	72
INCOME BEFORE TAXES ON INCOME	18,502	10,705	6,526	3,674	12,702
TAXES ON INCOME	4,159	3,491	1,505	1,349	3,787
NET INCOME FOR THE PERIOD	14,343	7,214	5,021	2,325	8,915
	<b>U . S . D o l l a r s</b>				
NET INCOME PER NIS 1 OF PAR VALUE OF SHARES	0.31	0.17	0.11	0.05	0.21

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

**FRUTAROM INDUSTRIES LTD.**  
**CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2003**

	<u>Share capital</u>	<u>Capital surplus</u>	<u>Differences from translation of foreign currency financial statements of subsidiaries</u>	<u>Retained earnings</u>	<u>Receivables in respect of allotment of share capital to senior employees, See note 5</u>	<u>Cost of company shares held by subsidiary</u>	<u>Total</u>
	U.S. dollars in thousands (see note 1c)						
<b>BALANCE AT JANUARY 1, 2004</b> (audited)	13,939	15,263	2,468	29,532		(619)	60,583
<b>CHANGES DURING THE 9 MONTHS ENDED SEPTEMBER 30, 2004</b> (unaudited):							
Net income				14,343			14,343
Allotment of share capital to senior employees (see note 6)	199	795			(994)		
Receipts in respect of allotment of share capital to senior employees					111		111
Plan for allotment of shares to subsidiary's employees:							
Purchase of company shares by subsidiary						(778)	(778)
Receipts in respect of allotment of shares to employees						78	78
Amortization of deferred compensation related to the plan						224	224
Dividend paid, see note 5				(1,144)			(1,144)
Differences from translation of foreign currency financial statements of subsidiaries			(174)				(174)
<b>BALANCE AT SEPTEMBER 30, 2004</b> (unaudited)	<u>14,138</u>	<u>16,058</u>	<u>2,294</u>	<u>42,731</u>	<u>(883)</u>	<u>(1,095)</u>	<u>73,243</u>
<b>BALANCE AT JANUARY 1, 2003</b> (audited)	12,758	4,812	390	21,529		(663)	38,826
<b>CHANGES DURING THE 9 MONTHS ENDED SEPTEMBER 30, 2003</b> (unaudited):							
Net income				7,214			7,214
Issuance of share capital net of issuance expenses	1,181	10,451					11,632
Plan for allotment of shares to subsidiary's employees:							
Purchase of company shares by subsidiary						(180)	(180)
Receipts in respect of allotment of shares to employees of subsidiary						42	42
Amortization of deferred compensation related to the plan						167	167
Dividend paid, see note 5				(912)			(912)
Differences from translation of foreign currency financial statements of subsidiaries			751				751
<b>BALANCE AT SEPTEMBER 30, 2003</b> (unaudited)	<u>13,939</u>	<u>15,263</u>	<u>1,141</u>	<u>27,831</u>		<u>(634)</u>	<u>57,540</u>

**FRUTAROM INDUSTRIES LTD.**  
**CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2003**

	<u>Share capital</u>	<u>Capital surplus</u>	<u>Differences from translation of foreign currency financial statements of subsidiaries</u>	<u>Retained earnings</u>	<u>Receivables in respect of allotment of share capital to senior employees, See note 5</u>	<u>Cost of company shares held by subsidiary</u>	<u>Total</u>
	U.S. dollars in thousands (see note 1c)						
<b>BALANCE AT JULY 1, 2004</b> (audited)	14,138	16,058	2,107	37,710	(994)	(979)	68,040
<b>CHANGES DURING THE 3 MONTHS ENDED SEPTEMBER 30, 2004</b> (unaudited):							
Net income				5,021			5,021
Receipts in respect of allotment of share capital to senior employees, see note 6					111		111
Plan for allotment of shares to subsidiary's employees:							
Purchase of company shares by subsidiary						(200)	(200)
Receipts in respect of allotment of shares to employees						4	4
Amortization of deferred compensation related to the plan							
Differences from translation of foreign currency financial statements of subsidiaries			187			80	80
	<u>14,138</u>	<u>16,058</u>	<u>2,294</u>	<u>42,731</u>	<u>(883)</u>	<u>(1,095)</u>	<u>73,243</u>
<b>BALANCE AT SEPTEMBER 30, 2004</b> (unaudited)							
<b>BALANCE AT JULY 1, 2003</b> (audited)	12,758	4,812	503	25,506		(571)	43,008
<b>CHANGES DURING THE 3 MONTHS ENDED SEPTEMBER 30, 2003</b> (unaudited):							
Net income				2,325			2,325
Issuance of share capital net of issuance expenses	1,181	10,451					11,632
Plan for allotment of shares to subsidiary's employees:							
Purchase of company shares by subsidiary						(144)	(144)
Receipts in respect of allotment of shares to employees of subsidiary						11	11
Amortization of deferred compensation related to the plan						70	70
Differences from translation of foreign currency financial statements of subsidiaries			638				638
	<u>13,939</u>	<u>15,263</u>	<u>1,141</u>	<u>27,831</u>		<u>(634)</u>	<u>57,540</u>
<b>BALANCE AT SEPTEMBER 30, 2003</b> (unaudited)							



**FRUTAROM INDUSTRIES LTD.**  
**CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2003**

	<u>Share capital</u>	<u>Capital surplus</u>	<u>Differences from translation of foreign currency financial statements of subsidiaries</u>	<u>Retained earnings</u>	<u>Cost of company shares held by subsidiary</u>	<u>Total</u>
	U.S. dollars in thousands (see note 1c)					
<b>BALANCE AT JANUARY 1, 2003</b> (audited)	12,758	4,812	390	21,529	(663)	38,826
<b>CHANGES DURING THE YEAR ENDED DECEMBER 31, 2003</b> (audited):						
Net income				8,915		8,915
Issuance of share capital	1,181	10,451				11,632
Plan for allotment of shares to subsidiary's employees:						
Purchase of company shares by subsidiary					(225)	(225)
Receipts in respect of allotment of shares to employees					51	51
Amortization of deferred compensation related to the plan					218	218
Dividend paid				(912)		(912)
Differences from translation of foreign currency financial statements of subsidiaries			2,078			2,078
<b>BALANCE AT DECEMBER 31, 2003</b> (audited)	<u>13,939</u>	<u>15,263</u>	<u>2,468</u>	<u>29,532</u>	<u>(619)</u>	<u>60,583</u>

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

**FRUTAROM INDUSTRIES LTD.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2004**

	<u>9 months ended</u> <u>September 30</u>		<u>3 months ended</u> <u>September 30</u>		<u>Year ended</u> <u>December 31</u>
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2003</u>
	<u>(Unaudited)</u>		<u>(Unaudited)</u>		<u>(Audited)</u>
	<u>U.S. dollars in thousands</u>				
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>					
Net income for the period	14,343	7,214	5,021	2,325	8,915
Adjustments required to reflect the cash flows from operating activities (a)	<u>1,164</u>	<u>(449)</u>	<u>2,132</u>	<u>1,934</u>	<u>1,758</u>
Net cash provided by operating activities	<u>15,507</u>	<u>6,765</u>	<u>7,153</u>	<u>4,259</u>	<u>10,673</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Purchase of property, plant and equipment	(3,076)	(2,036)	(1,130)	(716)	(3,055)
Acquisition of subsidiary and operations consolidated for the first time (b)	(33,976)	(13,229)	(33,976)	612	(13,262)
Proceeds from modification of purchase price of purchased operations (c)					179
Purchase of other assets (mainly knowhow)		(105)		(3)	(111)
Proceeds from sale of property, plant and equipment	103	51	43	28	142
Proceeds from sale of marketable securities		<u>2,032</u>		<u>2,032</u>	<u>2,032</u>
Net cash provided by (used in) investing activities	<u>(36,949)</u>	<u>(13,287)</u>	<u>(35,061)</u>	<u>1,953</u>	<u>(14,075)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Issuance of share capital, net of issuance costs		11,632		11,632	11,632
Receipt of long-term bank loans and credit		5,680		5,159	4,682
Repayment of long-term bank loans and credit	(9,088)	(6,532)	(3,261)	(4,166)	(9,753)
Short-term bank loan received for the purpose of financing the purchase of operations from IFF (see note 3)	33,984		33,984		
Repayment of long-term credit in connection with the acquisition of Flachsmann (b)	(1,196)				
Purchase of company shares by subsidiary – net	(700)	(138)	(196)	(133)	(174)
Short-term bank credit	1,627	(1,482)	514	(18,026)	(1,172)
Receipts from senior employees in respect of allotment of shares	111		111		
Dividend paid	<u>(1,144)</u>	<u>(912)</u>			<u>(912)</u>
Net cash provided by (used in) financing activities	<u>23,594</u>	<u>8,248</u>	<u>31,152</u>	<u>(5,534)</u>	<u>4,303</u>
<b>TRANSLATION DIFFERENCES ON CASH BALANCES OF CONSOLIDATED SUBSIDIARIES OPERATING INDEPENDENTLY</b>					
	<u>(1)</u>	<u>(102)</u>	<u>6</u>	<u>87</u>	<u>141</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	2,151	1,624	3,250	765	1,042
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<u>5,092</u>	<u>4,050</u>	<u>3,993</u>	<u>4,909</u>	<u>4,050</u>
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<u><u>7,243</u></u>	<u><u>5,674</u></u>	<u><u>7,243</u></u>	<u><u>5,674</u></u>	<u><u>5,092</u></u>

## FRUTAROM INDUSTRIES LTD.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2004

9 months ended September 30		3 months ended September 30		Year ended December 31
2004	2003	2004	2003	2003
(Unaudited)		(Unaudited)		(Audited)

U.S. dollars in thousands (see note 1c)

**(a) Adjustments required to reflect the cash flows from operating activities:**

Income and expenses not involving cash flows:

Depreciation and amortization	5,077	3,706	2,014	1,709	5,334
Liability for employee rights upon retirement – net	148	62	98	20	(144)
Deferred income taxes – net	(166)	(599)	(165)	(413)	48
Capital loss (gain) from sale of fixed assets	10	(13)	8	(5)	1
Gain from marketable securities		(13)		(13)	(13)
Erosion in respect of long-term receivable	97	(19)		(19)	(44)
Exchange differences on principal of long-term Loans					(103)
	<u>5,166</u>	<u>3,124</u>	<u>1,955</u>	<u>1,279</u>	<u>5,079</u>

Changes in operating asset and liability items:

Decrease (increase) in accounts receivable:

Trade	(11,474)	(7,267)	(5,455)	(1,099)	(2,235)
Other	(1,440)	(966)	(3)	576	(491)

Increase (decrease) in accounts payable:

Trade	3,832	2,154	3,423	57	373
Other	3,502	4,437	1,416	1,518	1,071

Decrease (increase) in inventories

	<u>1,578</u>	<u>(1,931)</u>	<u>796</u>	<u>(397)</u>	<u>(2,039)</u>
	<u>(4,002)</u>	<u>(3,573)</u>	<u>177</u>	<u>655</u>	<u>(3,321)</u>
	<u>1,164</u>	<u>(449)</u>	<u>2,132</u>	<u>1,934</u>	<u>1,758</u>

**(b) Purchase of company and operations****consolidated for the first time, see also note 3:**

Assets and liabilities of the company and operations at date of acquisition:

	9 and 3 months ended September 30, 2004	9 months ended September 30, 2003	Year ended December 31, 2003
	U.S. dollars in thousands		
Working capital (excluding cash and cash equivalents)	3,264	5,088	4,544
Long-term receivables		2,469	2,469
Fixed assets and other assets	33,754	28,898	25,098
Long-term liabilities	<u>(5,694)</u>	<u>(20,915)</u>	<u>(16,538)</u>
Add – amount receivable from IFF – adjustment of purchase price	31,324	15,540	15,573
	2,652		
Less - credit from former shareholders		<u>(2,311)</u>	<u>(2,311)</u>
	<u>33,976</u>	<u>13,229</u>	<u>13,262</u>

During the third quarter of 2003, the purchase price of the Swiss company Flachsmann was amended by the total amount of U.S. \$ 612,000.

**FRUTAROM INDUSTRIES LTD.**  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE NINE AND THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2004

**(c) Receipt in respect of amendment of the purchase price of purchased operation**

In 2002 the purchase price of an operation purchased in 2001 was amended by a total amount of U.S. \$ 761 thousands. In the years 2003 and 2002 the company received U.S. \$ 179 thousands and U.S. \$ 401 thousands, respectively, out of the abovementioned amount. The remaining amount is payable in two equal payments in the years 2006 and 2007.

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

## FRUTAROM INDUSTRIES LTD.

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

#### 1. General:

- a) The interim financial statements as of September 30, 2004 and for the nine and three-month periods then ended (hereafter – the interim statements) were drawn up in condensed form in accordance with accounting standard no. 14 of the Israeli Accounting Standards Board (“the IASB”) and in accordance with the Israeli Securities Regulations (Periodic and Immediate Reports), 1970.
- b) The accounting policies applied in preparation of the interim financial statements are consistent with those applied in the annual financial statements; nevertheless, the interim statements do not include all the information and explanations required for annual financial statements.

Costs that incur unevenly during the financial year are anticipated or deferred in the interim report only if it would also be appropriate to anticipate or defer such costs at the end of the financial year.

Income tax expense are included based on the best estimate of the anticipated average annual income tax rate expected for the entire year; changes in the said estimate, as well as changes in the amount of the tax saving to be utilized in the following years, are included as an expense for the current quarter (see also note 2 below).

- c) Through December 31, 2003, the company prepared its statutory financial statements on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency (hereafter – “NIS”), based upon changes in the exchange rate of the U.S. dollar (hereafter – “the dollar”), as permitted under section 29a of Opinion 36 of the Institute of Certified Public Accountants in Israel.

Taking into account the provisions of section 4 of Accounting Standard No. 13 – “Effect of Changes in Foreign Currency Exchange Rates” – issued by the Israel Accounting Standards Board (hereafter – “the IASB”), and since the dollar is the principal currency used in the company’s operations, the company draws up and presents, commencing January 1, 2004, its statutory financial statements in dollars. This presentation maintains continuity of the measurement basis, as formerly applied in the company’s financial statements.

The company draws up and presents its financial statements in dollars, as it used to do in the past.

**FRUTAROM INDUSTRIES LTD.**

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

**1. General** (continued):

d) Recently issued accounting pronouncement

In July 2004, the Israel Accounting Standards Board issued Accounting Standard No. 19 – “Taxes on Income”, which is based on International Accounting Standard No. 12, that sets the accounting treatment to be applied on taxes on income (recognition, measurement, presentation and disclosure).

This accounting standard will apply to financial statements relating to reporting periods commencing on January 1, 2005 or thereafter, and early implementation of the standard is recommended.

It is not expected that the implementation of the said standard will have a material effect on the company’s financial statements.

e) Following are the changes in the exchange rate of the U.S. dollar and the Israeli consumer price index during the reported periods:

	<b>Exchange rate of one U.S. dollar</b>	<b>Israeli CPI</b>
September 30, 2004	4.482	180.74
September 30, 2003	4.441	179.30
June 30, 2004	4.497	181.09
June 30, 2003	4.312	181.09
December 31, 2003	4.379	178.60
Average exchange rate of the dollar for the nine-month period ended September 30, 2004	<u>4.498</u>	
Rate of changes during the:	<u>%</u>	<u>%</u>
9 months ended September 30:		
2004	2.3	1.2
2003	(6.2)	(1.5)
3 months ended September 30:		
2004	(0.3)	(0.2)
2003	3.0	(1.0)
Year ended December 31, 2003	(7.6)	(1.9)

\* Based on the index for the month ending on balance sheet date, on the basis of 1993 average = 100.

## **FRUTAROM INDUSTRIES LTD.**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

AT SEPTEMBER 30, 2004

(UNAUDITED)

#### **2. Corporate tax reduction**

On June 29, 2004, the Israeli Parliament passed the Income Tax Ordinance Amendment (No. 140 and Ad Hoc Provision) Law, 2004 (hereafter – the Amendment), which provides for the gradual reduction – commencing from January 1, 2004 - in the rate of corporate tax from 36% to 30%, in the following manner: the rate for 2004 will be 35%, in 2005 – 34%, in 2006 – 32%, and in 2007 and thereafter – 30%. The Amendment was signed at the beginning of July 2004 by the officials authorized by the State of Israel to approve it, and was published in the Official Gazette of the Government of Israel on July 11, 2004.

The effect of the Amendment included in the financial statements for the period of the three months ended June 30, 2004, resulted in a decrease in the company's income tax expenses (current and deferred) for that period by U.S. \$ 190 thousands.

#### **3. Acquisition of European operations from International Flavors & Fragrances I.F.F Inc. (hereafter – IFF)**

##### **a) Acquisition of operations in Switzerland and Germany**

- (1) On August 17, 2004, the company completed the first stage of its acquisition of the Fruit Preparations activity (hereafter – FP) of IFF in Europe. As part of the FP activity, IFF is engaged in the development and manufacture of unique fruit preparations and other natural products used as supplements and flavors in the food industry.  
The FP operations of IFF was carried out in three plants, located in Switzerland, Germany and France. The purchase agreement has included, at first, only the purchase of the FP operations of the company's plants in Switzerland and Germany (see also b) below). According to this agreement, Frutarom has purchased, through its subsidiary in Switzerland, the fixed assets, intellectual property, inventory and prepaid expenses of the said plants, in consideration for € 30 million. The employees of the purchased activity have been accordingly transferred to the subsidiary, and so were the assets and liabilities related to the employees and to their retirement rights, which were evaluated at date of signing the agreement as liabilities at the amount of € 2.5 million. Accordingly, on August 18, 2004, the company paid IFF an amount of approximately € 27.5 million.  
The purchase agreement includes consideration adjustment mechanisms, which are defined in the agreement; those mechanisms include, inter alia, an earn-out of mechanism, whereunder, the purchase price may decrease or increase by additional € 3.5 million, in accordance with the results of the purchased operations in the years 2005 and 2006.  
The purchase agreement enables the company to continue manufacturing certain supplementary products to the customers of the purchased operations, in consideration for 50% of the gross profit arising from the sale of those products for a 5-year period commencing at date of purchase. In company's evaluation, the annual expense expected to arise in respect of this commitment is not material.
- (2) As of balance sheet date, the cost of acquisition of the operations amounts to \$ 32,322 thousands; this cost includes purchase expenses at the total amount of \$ 987 thousands, net of adjustments related to the purchase, at the total amount of \$ 2,652 thousands (presented as amounts receivable from IFF).

**FRUTAROM INDUSTRIES LTD.**

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

**3. Acquisition of European operations from International Flavors & Fragrances I.F.F Inc. (hereafter – IFF) (continued):**

The final cost of purchase depends upon setting the final price, after taking into account the results of the adjustment mechanisms described above. The cost of purchase was attributed to acquired tangible and intangible assets and to the acquired liabilities, based on their fair value at date of acquisition. The intangibles include: knowhow, customer relationships, technical support agreement and goodwill.

The fair value of the assets and liabilities is based on a preliminary evaluation of company's management, which is no final yet. The said evaluation is subject to adjustments, which may be required upon the final completion of the value assessments performed for the company.

- (3) The assets and liabilities of the FP operations purchased at this stage were included for the first time in the consolidated financial statements as of September 30, 2004. The results of the purchased operations for the period starting August 17, 2004 (date of purchase of operations) through September 30, 2004 were included for the first time in the consolidated financial statements for the 3-month period ended September 30, 2004.

Set forth below are the purchased FP operations data, as included in the consolidated financial statements as of September 30, 2004 (these operations constitute a part of the flavors division):

	<u>September 30,</u> <u>2004</u> <u>U.S. dollars</u> <u>in thousands</u>
Balance sheet:	
Current assets	14,495
Fixed assets – net	24,118
Other assets – net	8,981
Current liabilities	(7,920)
Long-term liabilities	<u>(5,750)</u>
	<u>33,924</u>
	<b>For the period from</b> <b>August 17, 2004 to</b> <b>September 30, 2004</b>
	<u>U.S. dollars</u> <u>in thousands</u>
Statement of income (loss):	
Sales turnover	<u>6,258</u>
Income From Ordinary Operations	<u>335</u>
Net income	<u>255</u>

**FRUTAROM INDUSTRIES LTD.**



NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

**3. Acquisition of European operations from International Flavors & Fragrances I.F.F Inc. (hereafter – IFF) (continued):**

- (4) The acquisition of the operations as above was financed by bank loans at the total amount of \$ 33,985 thousands. An amount of \$ 24,728 thousand was granted in Swiss Francs, and the remaining amount was in Euro. The loans are repayable within one year from the date they were received.

**b) Acquisition of operations in Switzerland and Germany**

On October 29, 2004 the company completed the second and last stage of the purchase of IFF European FP operations, as part of this stage, the FP operations of the company's plant in France in consideration for € 3.5 million (subject to certain adjustments as defined in the agreement, including adjustment mechanism based on profits, which was set in the agreement for the purchase of the operations in Switzerland and Germany, see a. above). The said purchase concerns the assets of the operations in France and does not include transfer of employees. The company intends to relocate the manufacturing activities to Germany and Switzerland for the purpose of reducing costs and utilizing the synergy between the purchased operations and the company's activities. The research and development operations, the marketing and selling operations, which serve the French market, will continue operating in France.

**4. Acquisition of the Flachsmann Group in 2003**

- a) The financial statements EMIL Flachsmann AG (hereafter – Flachsmann), which was purchased by the company on June 16, 2003, were consolidated for the first time in the financial statements of the company as of June 30, 2003; the consolidated statements of income for the year ended December 31, 2003 and for the 9 and 3 months periods ended September 30, 2004 include the results of operations of Flachsmann commencing July 1, 2003.
- b) As part of the said acquisition, the company has established a plan for the reorganization of the activities of Flachsmann. This reorganization plan will enable the company to reduce costs, merge the marketing activities and utilize the synergy between the company's and Flachsmann's activities. The plan mainly includes the merger of Flachsmann's activities in Canada and Europe with the company's existing activities, while reducing the number of Flachsmann's employees and also includes termination of activities of sites held by Flachsmann. The company has included in its accounts a provision in respect of the said costs upon acquisition. The company has borne the expenses arising from the said reorganization for the 9 and 3-month periods ended September 30, 2004 and for the year ended December 31, 2003 at the total amount of U.S. \$ 80 thousands, U.S. \$ 10 thousands and U.S. \$ 460 thousands, respectively.

**FRUTAROM INDUSTRIES LTD.**

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

**5. Proposed dividend**

On March 2, 2004, the company's board of directors resolved to distribute company's shareholders a dividend in the amount of U.S. \$ 1,144 thousands, out of retained earnings as of December 31, 2001. The dividend was paid on April 1, 2004.

**6. Allotment of shares and options to senior employees**

**a) Allotment of shares**

On December 21, 2003, the company's Board of Directors approved a new employee stock purchase plan for senior employees. Under this plan, the company will allot to the employees ordinary shares of NIS 1 par value, to be registered for trade in Tell Aviv Stock Exchange. The shares allotted are to be held by a trustee and they will be released to the employees, in equal batches, at the end of the vesting period; the vesting period is spread as follows: half a year (July 1, 2004), one year (January 1, 2005), two years (January 1, 2006) and three years (January 1, 2007).

On January 18, 2004, the company allotted 900,000 shares to senior employees, as part of the said plan. The market value of company's shares at date of allotment was NIS 19.64.

In consideration of the shares, the employees paid NIS 5 per share, using a loan they received for that purpose from the company. In case that an employee as above will not complete the vesting period, the company will repurchase from that employee the shares as against the offset of the employee's debt to the company. The loans to the employees are in NIS and they are unlinked and bear no interest. The loans are repayable upon sale of the share, or within 60 days from termination of the employee's employment, whichever is earlier, but not later than January 1, 2010.

In July and September 2004, the employees repaid a total of U.S. \$ 111 thousands out of the loans they were granted.

**b) Allotment of options**

On May 17, 2004, the company's board of directors approved, as part of an employee stock option plan (hereafter – the plan), the allotment of 150,000 non-marketable options (hereafter – the options) to a senior employee of the company; each option is exercisable into one ordinary share of NIS 1 par value.

**FRUTAROM INDUSTRIES LTD.**

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AT SEPTEMBER 30, 2004

(UNAUDITED)

**6. Allotment of shares and options to senior employees (continued):**

The said options are to be held by a trustee and they will be granted to the employee in equal batches at the end of the vesting period. The vesting periods are as follows: the first batch vests on October 9, 2004; the second on October 9, 2005; the third on October 9, 2006 and the fourth on October 9, 2007. In any case, the employee's right to exercise the options expires 6 years from date of grant (on May 17, 2010). The exercise price was set to NIS 10.87. The market value of the company's shares at date of allotment was NIS 20.94. On June 16, 2004, the Tel-Aviv Stock Exchange approved the registration of 150,000 company shares of NIS 1 par value, which will arise from exercise of the said options.

As allowed by accounting principles generally accepted in Israel, it is company's policy not to measure and record the notional compensation costs incidental to securities granted to employees, excluding costs involving cash outflow for the company.

**FRUTAROM INDUSTRIES LTD.**

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AT SEPTEMBER 30, 2004

(UNAUDITED)

**7. Business segment data:**

	<b>Flavors division</b>	<b>Fine ingredients division</b>	<b>Trade and Marketing division</b>	<b>Eliminations</b>	<b>Total Consolidated</b>
	U.S. dollars in thousands				
<b>9 months ended September 30, 2004</b>					
(unaudited):					
Segment revenues	<u>74,952</u>	<u>61,481</u>	<u>5,293</u>	<u>(1,878)</u>	<u>139,848</u>
Segment results	<u>13,442</u>	<u>5,990</u>	<u>240</u>		<u>19,672</u>
<b>9 months ended September 30, 2003</b>					
(unaudited):					
Segment revenues	<u>49,730</u>	<u>49,782</u>	<u>5,095</u>	<u>(1,756)</u>	<u>102,851</u>
Segment results	<u>6,997</u>	<u>4,302</u>	<u>248</u>		<u>11,547</u>
<b>3 months ended September 30, 2004</b>					
(unaudited):					
Segment revenues	<u>29,503</u>	<u>20,669</u>	<u>1,678</u>	<u>(488)</u>	<u>51,362</u>
Segment results	<u>4,588</u>	<u>2,088</u>	<u>65</u>		<u>6,741</u>
<b>3 months ended September 30, 2003</b>					
(unaudited):					
Segment revenues	<u>21,125</u>	<u>20,336</u>	<u>1,580</u>	<u>(668)</u>	<u>42,373</u>
Segment results	<u>2,329</u>	<u>1,729</u>	<u>40</u>		<u>4,098</u>
<b>Year ended December 31, 2003 (audited):</b>					
Segment revenues	<u>70,073</u>	<u>69,526</u>	<u>6,478</u>	<u>(2,401)</u>	<u>143,676</u>
Segment results	<u>9,216</u>	<u>4,831</u>	<u>236</u>		<u>14,283</u>



