

Frutarom Industries Ltd.
Directors' Report to the Shareholders
for the Period Ended September 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 natural extracts, and has significant manufacturing and development centers on three continents at which approximately 1,000 people are employed. Frutarom markets its products in over 100 countries worldwide.

The third quarter of 2004 is the 20th consecutive quarter in which the positive growth trend in the results of Frutarom's activity has continued. The Company's two divisions, the Flavors and Fine Ingredients Divisions, continued to increase their sales, margins, and profit while improving product mix. Ongoing growth in the core activities of Frutarom's two divisions is a central element in the ongoing implementation of Frutarom's strategy combining strong organic growth in core activities with growth through acquisitions. Recent acquisitions have allowed the Company to broaden the scope of its activities and knowhow and to enter strategic geographical markets, while focusing and expanding its activity at existing locations.

On August 17, 2004, Frutarom signed an agreement with International Flavors & Fragrances Inc. ("IFF") to acquire IFF's Food Systems (Fruit Preparations) business in Switzerland and Germany. On October 29, 2004, following IFF's completion of the consultation process with the French works council, an agreement to acquire the IFF Food Systems business in France was signed. The sales turnover of IFF's European Food Systems business was approximately US\$ 90 million in 2003. (The acquired business in Switzerland and Germany comprised 70% of IFF's total European Food Systems activity in 2003, and the acquired business in France comprised 30%.) The Food Systems 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 (yogurts and ice creams), sweet and savory bakery, and confectionery. The process of integrating the Food Systems business acquired in Switzerland and Germany into Frutarom's existing activities is underway and to date has proceeded according to plan. Following completion of the

agreement to acquire the Food Systems business in France, the Company has commenced the implementation of its plan to transfer the manufacturing activity currently conducted at IFF's plant in Dijon, France, to the modern Food Systems production sites in Germany and Switzerland in order to achieve synergies between the three sites' activity, achieve cost savings and increase efficiency. Management expects the transfer of the production activity in France to the sites in Germany and Switzerland to be completed by the end of the current year. The research, development, sales and marketing activities of the acquired Food Systems business, which are dedicated to the French market, will remain in France, an important target market in which Frutarom expects to significantly expand its activity.

The purchase price for the Food Systems business acquired in Germany and Switzerland was Euro 30 million (approximately US\$ 37 million). The purchase price for the Food Systems business and assets acquired in France was Euro 3.5 million (approximately US\$ 4 million), resulting in a total purchase price of Euro 33.5 million (approximately US\$ 41 million). The consideration paid was reduced by various liabilities assumed by Frutarom and adjustments for asset values. The acquisition agreement includes an earn out mechanism based on the results of the acquired business in 2005 and 2006, meaning that the acquisition price could decrease or increase by an additional Euro 3.5 million.

Acquiring IFF's Food Systems business in Europe constitutes an additional step in realizing and implementing the Frutarom Group's rapid growth strategy of recent years. The acquired activity is complementary to and synergetic with Frutarom's varied existing activities in the fields of natural flavor and fragrance materials and natural botanical extracts. The products, customers and geographic spread of the Food Systems business acquired from IFF are complementary to Frutarom's activities, with little duplication. Frutarom is working to best extract the considerable synergy with the acquired activities, while unifying management, research and development, operations, and sales and marketing infrastructures. The acquired Food Systems business is also expected to provide a stronger foundation for Frutarom in the savory field (non sweet flavors used in snacks, bakery, etc.). Frutarom believes that the acquired business will serve to leverage and strengthen its position as a leading supplier of comprehensive solutions—tastier, natural and adding health benefits to food products (functional foods), for the world's leading food manufacturers.

The results of the Food Systems business acquired in Switzerland and Germany are included as of August 17, 2004 in Frutarom's results of operations for the third quarter of 2004. The Food Systems business acquired in France is included in Frutarom's results of operations as of November 2, 2004. Frutarom's balance sheet for the third quarter fully consolidates the Food Systems assets acquired in Switzerland and Germany.

Frutarom's sales in the third quarter of 2004 totaled US\$ 51.4 million (NIS 230.0 million), a 21.2% increase compared with the same period in 2003. Gross profit for the period rose 26.1%, amounting to US\$ 16.9 million (NIS 75.8 million) compared with US\$ 13.4 million (NIS 58.8 million) during the same period in 2003, while the gross margin rose from 31.7% to 33.0%. Operating profit rose 74.1% to US\$ 6.9 million (NIS 30.7 million) compared with US\$ 3.9 million (NIS 17.2 million) in the same quarter of 2003. Operating profit reached 13.3% compared with 9.3% during the same period in 2003. Net profit increased by 116.0%, reaching US\$ 5.0 million (NIS 22.5 million) compared with US\$ 2.3 million (NIS 10.2 million) in the third quarter of 2003. Net margin also improved, reaching 9.8% compared with 5.5% in the same period in the previous year.

Together with this increase in sales, during the third quarter Frutarom also achieved improvement in the cash flow from operating activities of US\$ 7.2 million (NIS 32.1 million) compared with US\$ 4.3 million (NIS 18.7 million) during the same quarter last year.

Frutarom's sales for the first three quarters of 2004 totaled US\$ 139.8 million (NIS 629.0 million), a 36.0% increase compared with the same period in 2003, when sales totaled US\$ 102.9 million (NIS 450.4 million). Gross profit for the first nine months of 2004 rose 42.8%, amounting to US\$ 47.4 million (NIS 213.4 million) compared with US\$ 33.2 million (NIS 145.5 million) in the same period in 2003. Gross margin rose from 32.3% to 33.9%. Operating profit increased 68.8% to US\$ 19.1 million (NIS 86.1 million) compared with US\$ 11.3 million (NIS 49.7 million) during the same period in 2004. Operating profit reached 13.7% compared with 11.0% during the same quarter in 2004. Net profit rose by 98.8% to total US\$ 14.3 million (NIS 64.5 million) compared with approximately US\$ 7.2 million (NIS 31.6 million) in the first three quarters of 2003. Net margin also rose, to 10.3% compared with 7.0% during the same period in 2003.

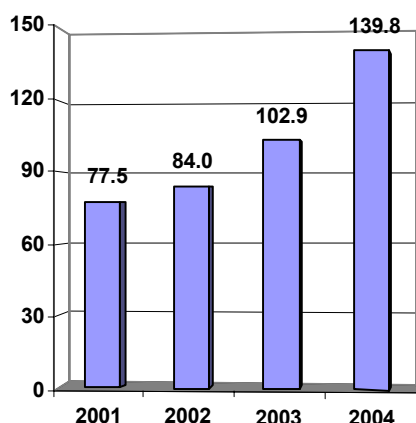
During the first three quarters of 2004 Frutarom achieved a positive cash flow from operating activities of US\$ 15.5 million (NIS 69.8 million) compared with US\$ 6.8 million (NIS 29.6 million) during the same period in 2003.

The Company's equity capital as at September 30, 2004 amounted to US\$ 73.2 million (NIS 328.3 million), which comprises 37.6% of the balance sheet, compared with US\$ 57.5 million (NIS 252.0 million) on September 30, 2003, which comprised 39.0% of the balance sheet.

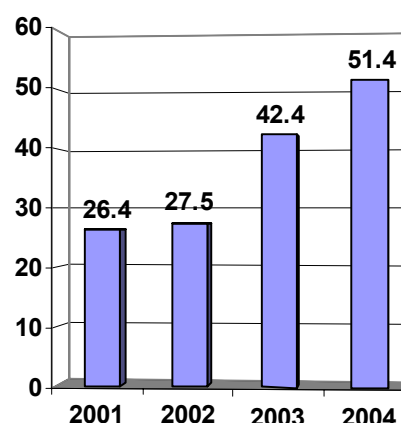
The growth in net profit in recent years is a result of, *inter alia*, the sustained rapid growth trend in Frutarom's activities, both through the organic growth of core activities in the Flavors and Fine Ingredients Divisions, and through the successful integration of businesses acquired in recent years. The Company's continued improvement to product mix while achieving steady growth in the Flavors Division's (the most profitable of Frutarom's activities) portion of the Company's overall activity (53.6% in the first three quarters of 2004 compared with 48.8% in 2003 and 28.4% in 1999) has also contributed to the growth in net profit. The improvement to product mix and the growth in net profit also derive from the Fine Ingredients Division's focus on developing and introducing new products with comparatively higher than average margins. Although the Company has continued to expand its activities in recent years, it has maintained a policy of cost control, which has also contributed to the growth in profit and margins achieved in recent years.

Sales Development (US\$ million)

First Three Quarters: 2001-2004



Third Quarter: 2001-2004



Frutarom invests considerable effort in continuing to implement its rapid growth strategy, which has been successfully implemented in recent years, with a view to becoming one of the ten global leaders in the flavor and fine ingredients industry.

I. Brief Description of the Company and its Business Environment

Frutarom is active through two main divisions: the Flavors Division and the Fine Ingredients Division. Frutarom's Flavors Division develops, produces and markets flavors and food systems intended mainly 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 natural medicinal extracts, essential oils, and other natural ingredients used mainly in the food, flavor, fragrance, pharmaceutical and nutraceutical, health and functional food, 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 at its plants in the United States, Israel, Switzerland, Germany, the United Kingdom, Denmark, Turkey and China, and are sold to over 3,500 customers in more than 100 countries on five continents. Frutarom's international marketing infrastructure includes branches in the United States, Israel, Switzerland, the United Kingdom, France, Germany, Denmark, Romania, Russia, Ukraine, Kazakhstan, Belarus, Turkey, Brazil, Mexico, China, Hong Kong, and India. The Company also works through local agents and distributors worldwide.

Changes in consumer consumption habits and preferences worldwide, together with the constant rise in the average age of the world's population, have led to a rapid growth trend in demand for both natural products and products with added health qualities and values (functional foods). Frutarom estimates that the Company's capabilities and strengths, to which acquisitions (namely Flachsmann and the Food Systems business) made in recent years contribute, will serve to

leverage and strengthen Frutarom's position as a leading supplier of natural flavor materials that offers comprehensive solutions—tasty, natural and healthy—to the world's leading food manufacturers, including a wide and innovative range for the functional food industry.

Management believes that Frutarom benefits from a competitive advantage in the field of functional foods, which is developing rapidly throughout the world, due to its proven abilities in the fields of botanical extraction and of natural flavors for the food industries, and Food Systems. These two fields of expertise combine Frutarom's capabilities and 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 is an added advantage, providing the Company with the opportunity to be a prominent supplier in the functional food segment and achieving a significant competitive advantage and differentiation, which it seeks to leverage.

Frutarom considers the continued strengthening of its presence in target markets and particularly in emerging markets possessing a growth rate higher than the average for the western world, to be a central element of its growth strategy for the future. Accordingly, in recent years Frutarom established subsidiaries in China, Turkey, Russia, Ukraine, Kazakhstan, Romania and Belarus. Frutarom estimates that it will continue to deepen its penetration and expand its activity to additional emerging markets, in parallel with continuing to strengthen its position in western markets that it already has a substantial presence in. Frutarom will continue to develop unique products that are tailor made to fit the needs of its customers in all its markets, including those among the leading multinational food manufacturers in the world as well as medium sized, local customers in strategic target countries. Frutarom regards its ability to provide mid sized, local customers with comprehensive, quality service on a level generally only given to leading multinationals as a competitive advantage that it works to take best advantage of. Frutarom also sees this as an important element of its growth strategy.

II. Results of Activities

Frutarom's sales during the third quarter of 2004 totaled US\$ 51.4 million, an increase of 21.2% compared with US\$ 42.4 million during the same quarter in 2003.

The following contributed to the growth in sales:

- A. The merger of the Food Systems business acquired from IFF in Switzerland and Germany with Frutarom's global activities. The newly acquired Food Systems business considerably expanded Frutarom's product portfolio, customer base and geographical reach (allowing it to expand in regions and countries in which Frutarom had not had a significant presence to date, such as France, Spain, Italy, Norway and North Africa). Frutarom is continuing to work diligently to develop the considerable synergies existing between its activities and those of the Food Systems business acquired from IFF.
- B. The continued accelerated growth in sales in recent years of 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 three quarters of 2004 the Flavors Division's activity contributed over 50% of Frutarom's total sales. Frutarom expects to continue to invest in and strengthen all of the Flavors Division's sites in coming years, and regards the Flavors Division as a central element of its business development strategy for the future.
- C. Continued consolidation and strengthening of Frutarom's global research, development, sales and marketing networks. This includes the emerging market regions where Frutarom has recently begun its activities and where the growth rate, including of processed foods consumption, is significantly higher than the global average.
- D. Growth of the Fine Ingredients Division's sales, with the contribution of new products developed in Frutarom's research and development laboratories.

These new products have on average higher margins in markets in which Frutarom has a competitive advantage.

This year's cool and rainy summer in Europe, where Frutarom has a significant presence, had an adverse effect on the sales of some of Frutarom's customers, particularly in the beverage and ice cream fields. Despite this, Frutarom succeeded in achieving growth in all the fields of its core business even during the third quarter of the year.

Breakdown of Sales by Activity 1999–2004

Segment	1999	2000	2001	2002	2003	Jan.–Sept. 2004
Flavors Division	28.4%	32.4%	38.8%	42.3%	48.8%	53.6%
Fine Ingredients Division	62.8%	59.8%	55.6%	52%	46.7%	42.6%
Trade & Marketing	8.8%	7.8%	5.6%	5.7%	4.5%	3.8%

Frutarom's gross profit rose 26.1% during the third quarter of 2004 to US\$ 16.9 million compared with US\$ 13.4 million during the third quarter of 2003. The gross margin also rose from 31.7% to 33.0% over the same period.

Selling, administration and general expenses for the third quarter of 2004 totaled US\$ 10.1 million, compared with US\$ 9.5 million during the same quarter in 2003. The increase in expenses is mainly a result of the growth in Frutarom's activities and the addition of the Food Systems business in Germany and Switzerland acquired from IFF, during the period since the acquisition.

Operating profit for the third quarter of 2004 continued the upward trend of past years to reach US\$ 6.9 million, growing 74.1% compared with the third quarter of 2003. In parallel with the rise in operating profit, operating margin continued to grow, reaching 13.3% in the third quarter of 2004 compared with 9.3% in the same period in 2003.

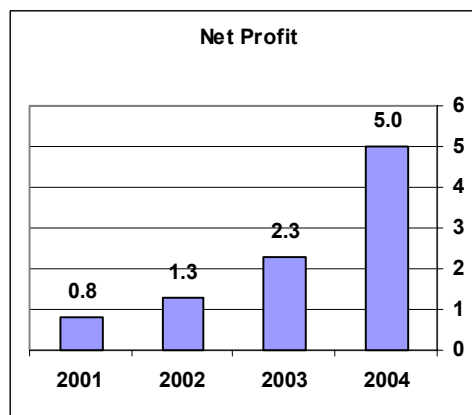
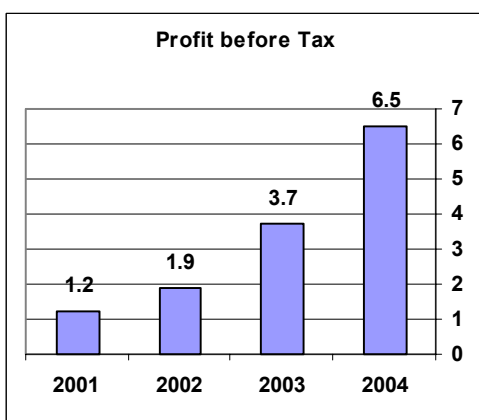
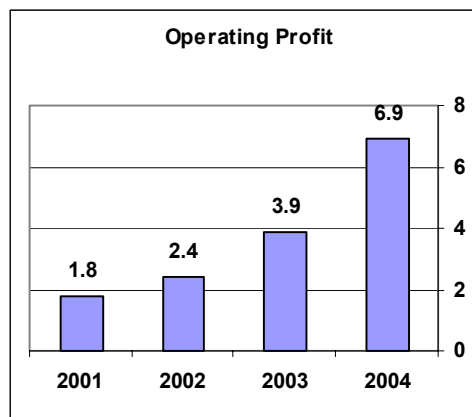
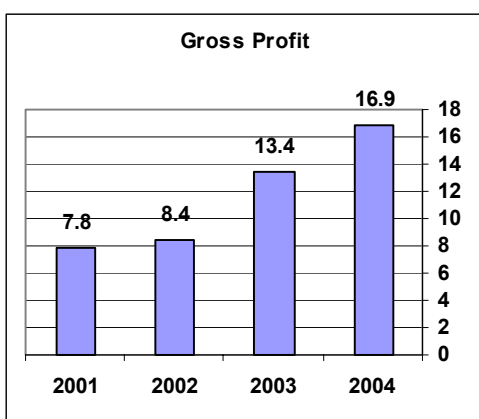
Finance expenses for the third quarter of 2004 totaled US\$ 0.35 million, compared with US\$ 0.28 million in the same quarter last year.

Profit before tax for the third quarter of 2004 rose 77.7% to US\$ 6.5 million compared with US\$ 3.7 million during the same quarter of 2003. Profitability rose from 8.7% to 12.7%.

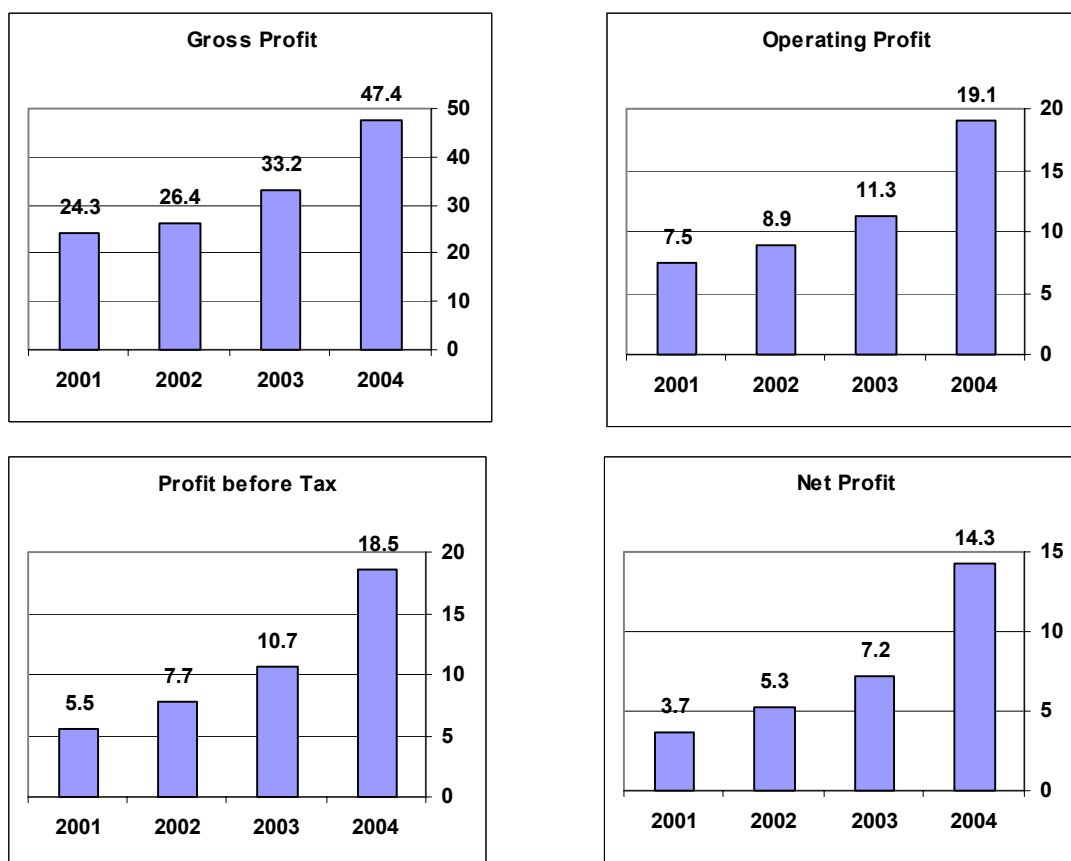
Tax expenses for the third quarter of 2004 totaled US\$ 1.5 million compared with US\$ 1.3 million in the same quarter of 2003.

Net profit for the third quarter grew 116.0% to reach US\$ 5.0 million compared with US\$ 2.3 million during the third quarter of 2003. The net profit margin also increased, reaching 9.8% compared with 5.5% during the third quarter of 2003.

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



Profit Development – First Three Quarters in 2001–2004 (US\$ million)



III. Financial Status

Total assets at September 30, 2004 amounted to US\$ 194.9 million, compared with US\$ 147.4 million at September 30, 2003.

The Company's current assets totaled US\$ 94.6 million compared with US\$ 77.3 million at the end of the same quarter last year.

Net fixed and other assets totaled US\$ 97.8 million on September 30, 2004 compared with US\$ 67.7 million at the end of the same quarter in 2003.

IV. Liquidity

During the third quarter of 2004, cash flow from operating activities reached US\$ 7.2 million compared with a cash flow of US\$ 4.3 million during the same quarter last year. The cash flow generated during the quarter was used to reduce debt, for investments made by Frutarom, and to increase its cash reserves.

V. Sources of Finance

A. Equity

The Company's equity as at September 30, 2004 totaled US\$ 73.2 million (37.6% of the total balance sheet). The increase in the Company's equity during the third quarter resulted mainly from the Company's profit for the quarter in the amount of US\$ 5.0 million.

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

The average long term credit from banks totaled US\$ 33.5 million. During the same quarter last year, the Company had long term credit of US\$ 40.9 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\$ 24.8 million. During the same quarter last year, the Company had short term credit of US\$ 1.2 million at its disposal. The growth in short term credit at the Company's disposal derives mainly from the acquisition of the Food Systems activity in Germany and Switzerland from IFF, which was financed with bank credit.

D. Credit From Suppliers and Customers (Quarterly Average)

The average credit from suppliers and other creditors was US\$ 37.0 million (US\$ 34.2 million during the same period in 2003). During the third quarter of 2004, Frutarom granted average credit of US\$ 38.0 million to receivables (US\$ 30.1 million during the same period in 2003). The growth in credit to

receivables results from the growth in activity compared with the same quarter 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

On October 29, 2004, following IFF's completion of the consultation process with the French workers council, Frutarom and IFF signed an agreement for the acquisition of the assets of IFF's Food Systems activity in France.

The Board of Directors of the Company held four 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

November 14, 2004