FRUTAROM INDUSTRIES LTD.
DIRECTORS REPORT TO THE SHAREHOLDERS
FOR THE PERIOD ENDING DECEMBER 31, 2004[1]

General

Frutarom Industries Ltd. ("Frutarom" or "the Company") is a global company established in 1933 that became a public company in 1996. Frutarom develops, produces and markets flavors and fine ingredients used to produce food and beverages, flavors and fragrances, pharma/nutraceutical, personal care and other products. Frutarom produces, markets and sells over 14,000 products a year to more than 3,500 customers in more than 100 countries and operates production facilities in Europe, North America, Israel and Asia.

In recent years Frutarom has implemented a strategy for achieving rapid, above-industry average growth, both through internal growth and through strategic acquisitions. Frutarom focuses on large multinational customers as well as mid size and local customers, offering each customer the same superior service, and tailor made products for each customer's unique needs. Frutarom concentrates on developed markets such as Western Europe and the United States, as well as fast growing emerging markets such as CIS, Eastern Europe and Asia. Frutarom offers its customers a wide range of products comprising mostly natural products and innovative, value-added specialty products such as natural functional food ingredients, and continues to invest in the Company's research and development activities.

The Company's activity is divided into two main divisions: the Flavors Division and the Fine Ingredients Division:

- Frutarom's Flavors Division develops, produces, markets and sells flavors and Food Systems used mainly by manufacturers of food, beverages and other consumer products. Frutarom develops for its customers thousands of different flavors, most of which are tailor made for a specific customer, and continuously develops new flavors in order to meet changing consumer preferences and future customer needs. The Flavors Division is the most profitable of Frutarom's Divisions and has experienced accelerated growth in recent years. Sales of the Flavors Division increased from US$ 45.3 million in 2002 to US$ 110.9 million in 2004, in line with Frutarom's growth strategy, as a result of both organic growth and a number of strategic acquisitions. The internal growth in the Flavors Division's sales derives from the Division's focus on both developed and emerging markets by providing superior service to both multinational and mid sized, local customers.

[1] Prepared in accordance with the consolidated financial reports of Frutarom Industries Ltd. which were prepared in accordance with the IFRS as required by UKLA

- Frutarom's Fine Ingredients Division develops, produces, markets and sells natural flavor extracts, natural functional food ingredients, natural pharma/nutraceutical extracts, specialty essential oils, citrus products, aroma chemicals, natural gums and peptide building blocks. The products of the Fine Ingredients Division are sold principally to the food and beverage, flavor and fragrance, pharma/nutraceutical and personal care industries. The Fine Ingredients Division has experienced significant growth in recent years, with sales increasing from US$ 57.7 million in 2002 to US$ 81.7 million in 2004 as a result of both internal growth and several strategic acquisitions. The internal growth in the Fine Ingredients Division's sales is principally the result of Frutarom's strategy of focusing on the development of new, innovative added value products, a higher margin and the large natural product portfolio that represents approximately 70% of the Division's sales, in addition to the Company's superior service to its multinational, mid sized and local customers as part of Frutarom's rapid growth strategy.

- In addition to its flavors and fine ingredients activities, Frutarom imports and markets to its customers in Israel various raw materials manufactured by third parties. This activity is not considered a core activity by the Company's management.

2004 was an excellent year for Frutarom. The Company continued its trend of increased sales, profitability and profits for the fifth consecutive year. During 2004, Frutarom continued to successfully implement its strategy of rapid growth, combining organic growth in its core business (which is growing at a rate surpassing the industry average) with strategic acquisitions of activities and knowhow in its main fields of business and in strategic geographical areas.

In 2004, Frutarom established its position as one of the leading flavors and fine ingredients producers in the world. The activity of Emil Flachsmann AG ("Flachsmann"), which was acquired in 2003, was successfully integrated with Frutarom's existing activity. In so doing, Frutarom concluded the first stage of the integration and began the second stage of taking advantage of the many cross-selling opportunities. Frutarom believes that it will be able to realize additional cross- selling possibilities in the future that will support its continued growth.

As part of implementing its rapid growth strategy, during the second half of 2004 Frutarom completed the acquisition of International Flavors & Fragrances, Inc.'s ("IFF") European Food Systems activity in Switzerland, Germany and France. The Food Systems activity develops, produces and markets food systems used in a wide variety of products, such as dairy (yogurt, ice cream), sweet and savory bakery and confectionery. The acquisition of IFF's European Food Systems activity considerably expanded Frutarom's multinational food and beverage customer base, geographic reach in Europe (including entry to countries where Frutarom had a negligible or no presence) and product portfolio (including new products that combine flavors, natural functional food ingredients and Food Systems), while also strengthening its savory flavor offering. The acquisition gives Frutarom many new possibilities and opportunities for cross-selling between the new customers and products following the acquisition and its existing products and customers.

Following completion of the acquisition of the Food Systems activity in France, Frutarom implemented a reorganization program, including transferring the production activity previously conducted by IFF in France to Frutarom's Food Systems production sites in Germany and Switzerland , this was done in order to achieve cost savings and increase production efficiency, and the integration of Frutarom's existing Food Systems activity in England. In addition, the sales and marketing and research and development teams in Europe were fully integrated. With the completion of the reorganization process during the fourth quarter of 2004, the first step of integrating the food systems activity with Frutarom's existing activity ended, and the second stage of extracting the many cross- selling possibilities in the acquisition began.

The agreed purchase price for the acquisition of IFF's Food System activity in Germany and Switzerland was Eur 30 million, and in France, Eur 3.5 million. After the various liabilities assumed by Frutarom and adjustments for net asset value were deducted, the purchase price for the acquisition of the IFF Food System activity in Germany and Switzerland was Eur 28 million, and in France, Eur 2.5 million (a total of approximately US$ 38 million). The acquisition agreement determined an earn out mechanism based on the results of the acquired activity in 2005 and 2006, as a result of which the final purchase price may decrease or increase by up to an additional Eur 3.5 million.

The results of the activities acquired in Switzerland and Germany were consolidated from August 17, 2004 with Frutarom's results for 2004. The activity acquired in France is included in the results of Frutarom's activity as of November 2, 2004. Frutarom's balance sheet for the end of 2004 includes the entire assets of the activity acquired in Switzerland, Germany and France.

Frutarom’s sales for 2004 totaled US$ 196.8 million, growing 41.2% compared with 2003, when sales reached US$ 139.3 million. Gross profit for 2004 rose 49.1% to reach US$ 74.3 million compared with US$ 49.9 million in 2003. Gross margin rose from 35.8% to 37.8%. Operating profit rose 75.2% to US$ 22.0 million compared with US$ 12.6 million in 2003. Operating margin rose to 11.2`% compared with 9.0% in 2003. Net profit grew significantly by 96.1%, reaching US$ 15.8 million compared with US$ 8.0 million in 2003. Net margin was 8.0% of sales compared with 5.8% last year.

The cash flow from current activities achieved by the Company in 2004 was US$ 17.3 million compared with US$ 10.1 million in 2003. The acquisition of IFF's Food Systems business was financed with short term loans from Swiss banks. Current activity was financed through the Company's current cash flow.

Frutarom’s equity totaled US$ 78.7 million as at December 31, 2004, which is 36.8% of the balance sheet, compared with US$ 59.6 million as at December 31, 2003, which is 42.4% of the balance sheet.

Frutarom's sales for the fourth quarter of 2004 totaled US$ 56.9 million, growing 51.0% compared with the fourth quarter of 2003. Gross profit for the quarter rose 52.6% to reach US$ 20.2 million compared with US$ 13.3 million in the same period last year. Operating profit rose 246% to reach US$ 4.3 million compared with US$ 1.2 million during the same quarter in 2003. Operating margin reached 7.5% compared with 3.3% during the same period in 2003. Net profit rose sharply by 275.7% to reach US$ 3.0 million compared with US$ 0.8 million in the fourth quarter of 2003. Net margin reached 5.3% compared with 2.1% in the same quarter of last year.

The increase in net profit seen in recent years derives, among others, from the rapid growth in Frutarom's activity; growth resulting from organic growth in core activities in both the Flavors Division and the Fine Ingredients Division, and the successful integration of activities acquired in recent years. The continued improvement in product mix, mainly the proportion of Frutarom's total sales represented by the Flavors Division (which typically have higher margins compared to fine ingredients products) has progressively increased, reaching 56.4% of total sales in 2004 compared with 49.0% in 2003 and 42.1% in 2002, also contributed to the improvement in net profit. The Fine Ingredients Division, which is focusing on developing and introducing new, innovative and added value products with a higher margin also contributed to the improvement in Frutarom's product mix and net profit. Alongside the growth in activity in recent years, Frutarom maintained a policy of closely controlling growth of expense levels, which has contributed to the increases in profit and profitability.

Frutarom is focused on implementing its rapid growth strategy of recent years in order to strengthen its position as one of the leading flavor and fragrance companies.

In February 2005, Frutarom completed an US$ 80.9 million offering on the London Stock Exchange Official List. The net proceeds in connection with the Offering (net of underwriting commissions and other fees and expenses, which totaled US$ 5.1 million), will be approximately US$ 75.8 million. This offering added top international investors to the Frutarom's shareholders portfolio, improved its equity structure, contributes to its positioning as a global company and principally gives the Company the resources required to continue implementing strategic acquisitions as part of its rapid growth strategy.

Results of Activity in 2004

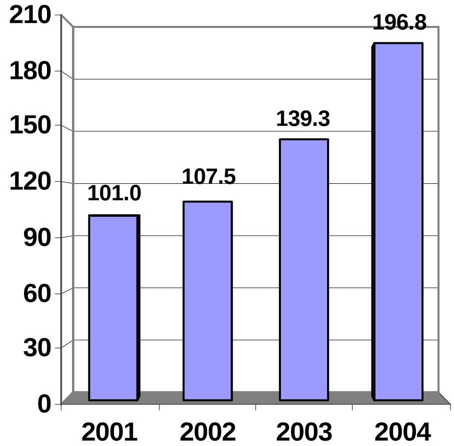
Following is a summary from the annual profit and loss report (US$ million):

	2004	2003	Change (%)
Sales	196.8	139.3	41.2%
Gross profit	74.3	49.9	49.1%
Selling, Marketing, R&D, Administration and General expenses	52.3	37.3	40.3%
Operating profit	22.0	12.6	75.2%
EBIDTA	31.1	17.5	77.6%
Financial expenses	1.3	1.0	35.2%
Profit before tax	20.7	11.6	78.6%
Net profit	15.8	8.0	96.1%

Sales

Frutarom's sales in 2004 totaled US$ 196.8 million, showing growth of 41.2% compared with 2003, when sales totaled US$ 139.3 million. This growth was achieved in an industry showing growth at an average rate of 2% to 4% each year.

Sales Development in 2001 – 2004 (US$ million)



The following factors influenced the growth in sales:

A. The merger of the Food Systems activity acquired from IFF in Switzerland, Germany and France with the Frutarom Group's global activity. The results of the activities acquired in Switzerland and Germany were consolidated as of August 17, 2004 with Frutarom's results for 2004. The activity acquired in France is included in the results of Frutarom's activity as of November 2, 2004. The acquired activity contributed US$ 20.6 million to Frutarom's sales in 2004.

B. Continuing the successful merger of Flachsmann in Switzerland and its subsidiaries in Canada and Denmark with the Frutarom Group's global activity.

C. The continued accelerated growth trend in recent years in the Flavors Division (which typically have higher margins compared to fine ingredients products), due to the consolidation and strengthening of activity in its subsidiaries worldwide. The Flavors Division has achieved double-digit organic growth rates in recent years. In 2004, the Division's sales as a proportion of Frutarom's total sales was 56.4% compared with 42.1% in 2002. Frutarom will continue to expand and strengthen its flavors business both by bolstering its presence in developed and emerging markets where it currently operates and by entering into new markets, and will continue to review new strategic acquisitions.

D. Continued consolidation and strengthening of Frutarom's global research, development, sales and marketing network, including in emerging markets where the demand for processed food products is growing at a higher rate than the global average.

E. Growth in the Fine Ingredients Division's sales, to which new, innovative, high margin products developed in Frutarom's research and development laboratories contributed.

F. The especially cold and rainy summer that hit Europe in 2004, where Frutarom has a significant presence, harmed the sales of some Frutarom customers, mainly in beverages and ice cream. Nevertheless, Frutarom was still able to succeed in growing all of its core activities during the second half of the year.

Breakdown of Sales by Geographic Region

Most of the Company's sales are in Europe, North America, Israel, Asia and the Far East. In 2004, 52.0% of the Company's sales were in Europe, 15.4% in North America, 13.9% in Israel, 12.4% in Asia and the Far East and 6.4% in other countries.

The following table sets forth the Company's sales in 2003 and 2004 broken down by geographic regions (US$ million):

	2004	2003	Change (%)
Europe	102.2	53.6	90.7%
North America	30.3	28.9	4.8%
Israel	27.3	24.9	9.6%
Asia and Far East	24.4	23.1	5.6%
Other	12.5	8.8	42.8%
Total	196.8	139.3	41.2%

A combination of internal growth in core activities and strategic acquisitions made by the Company in recent years (the acquisition of flavors and fine ingredients activity from CPL Aromas Ltd. in 2001, of Flachsmann in 2003 and of IFF's Food Systems activity in 2004) increased the Company's sales in Europe significantly. As part of its strategy, Frutarom intends to grow the degree of sales in North America through a combination of internal growth and strategic acquisitions. Due to the global growth in sales, Israel's relative portion decreased in spite of the growth in sales to this market. Frutarom's management estimates that the trend of decline in the Israeli market portion out of Frutarom's total sales will continue in the next few years, in view of the relatively small size of the Israeli market and the expected growth in Frutarom's global activity.

Breakdown of Sales by Fields of Activity in 2000-2004 (in % and US$ million)

The following table set forth the Company's sales from 1999 through 2004 broken down by field of activity:

		2000*	2001	2002	2003	2004
Flavors Division	Sales	26.5	39.1	45.3	68.2	110.9
	%	33.0%	38.7%	42.2%	49.0%	56.4%
Fine Ingredients Division**	Sales	47.7	56.3	56.0	64.6	79.1
	%	59.2%	55.6%	52.1%	46.4%	40.2%
Trade & Marketing	Sales	6.3	5.6	6.2	6.5	6.8
	%	7.8%	5.6%	5.7%	4.6%	3.4%

* 2000 figures are based on Israeli GAAP
** Net of interdivisional sales

Frutarom derives sales principally from two divisions: the Flavors Division and the Fine Ingredients Division.

In recent years, the growth in the Flavors Division's sales, which typically generate higher margins than fine ingredients products, as a proportion of Frutarom's total sales has progressively increased, reaching 56.4% of total sales in 2004 compared with 42.2% in 2002. The increase in 2004 results from the rapid internal growth in recent years in its sales and the growth in this Division resulting from the inclusion of the activity acquired from IFF during the second half of 2004. The Company estimates that the Flavors Division's proportion will continue to grow during 2005. Alongside the growth in the Flavors Division, the relative proportion of the Fine Ingredients Division decreased in 2004 to 40.2% compared with 52.1% in 2002. The relative portion of the Trade & Marketing activity also decreased in 2004, to 3.4% compared with 5.7% in 2002. The Trade & Marketing activity is not considered a core activity by Frutarom's management.

Gross Profit

Gross profit for 2004 grew 49.1% to reach US$ 74.3 million compared with US$ 49.9 million in 2003. Gross margin rose from 35.8% in 2003 to 37.8% in 2004. This increase is the result of the growth in sales, improvement to the product mix and the utilization of synergism and efficiency in the Company.

Selling, Marketing , Research and Development, Administration and General Expenses

Selling, marketing, research and development, administration and general expenses totaled US$ 52.3 (26.6% of sales) in 2004 compared with US$ 37.3 million (26.8% of sales) during 2003. The growth in expenses is mainly the result of the growth in Frutarom's activity during the period following the acquisition from IFF in 2004 and the addition of the activity acquired from Flachsmann in June 2003.

In 2004, Selling, marketing ,research and development, , administration and general expenses rose as a result of the acquisition of IFF's Food Systems activity in 2004, the acquisition of Flachsmann in June 2003 and the growth in Frutarom's core activity turnover. These expenses rose at a lower rate than the growth in sales.

Operating Profit

Operating profit continued in 2004 the growth trend of recent years, totaling US$ 22 million, a sharp rate of growth reaching 75.2% compared with 2003. Parallel to the growth in operating profit, the growth trend in operating margin also continued, reaching 11.2% compared with 9.0% in 2003.

Finance Expenses

Finance expenses for 2004 totaled US$ 1.3 million (0.7% of sales) compared with US$ 1.0 million (0.7% of sales) in 2003. Financial expenses were influenced by the scope of the average debt in 2004 compared with 2003.

Profit Before Tax

Profit before tax grew 78.6% in 2004 to reach US$ 20.7 million (10.5% of sales) compared with US$ 11.6 million in 2003 (8.3% of sales).

Taxes on Income

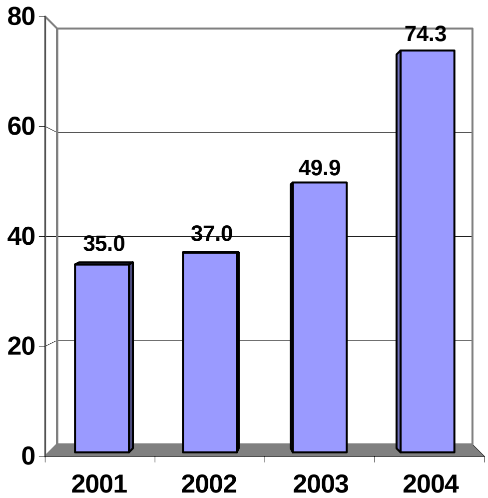
Taxes on income in 2004 totaled US$ 4.9 million (23.8% of profit before tax) compared with US$ 3.5 million in 2003 (30.6% of profit before tax). The rate of taxes on income declined due to the relative growth in profit in countries where the tax rate is lower than Frutarom's average tax rate.

Net Profit

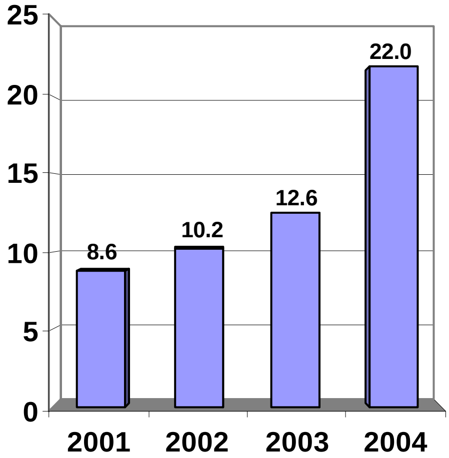
Net profit rose sharply in 2004 by 96.1% to reach US$ 15.8 million compared with US$ 8.0 million in 2003. Net margin reached 8.0% compared with 5.8% in 2003.

Profit Development – 2001 – 2004 (US$ million)
(2001 figures based on Israeli GAAP)

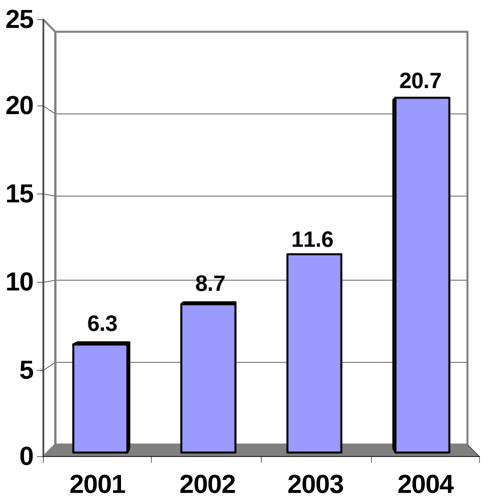
Gross Profit



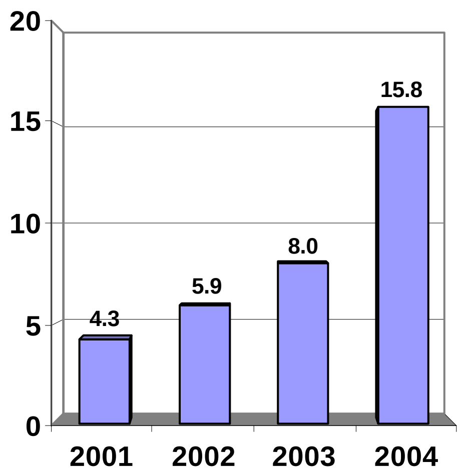
Operating Profit



Profit before Tax



Net Profit



Results of Activity during the Fourth Quarter of 2004

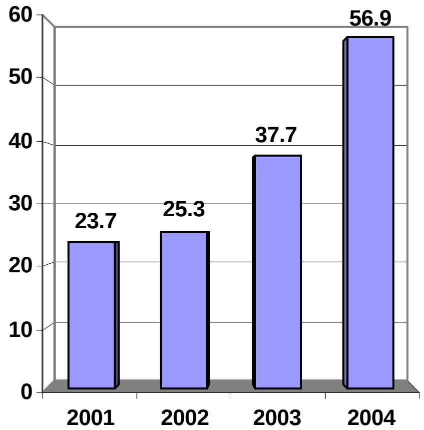
Following is a summary of the profit and loss report for the fourth quarter (US$ million):

	2004	2003	Change (%)
Sales	56.9	37.7	51.0%
Gross profit	20.2	13.3	52.6%
Selling, marketing, R&D Administration and General expenses	15.9	12.0	32.7%
Operating profit	4.3	1.2	246.0%
EBIDTA	6.7	2.5	165.9%
Financial expenses	0.6	0.3	69.2%
Profit before tax	3.7	0.9	309.0%
Net profit	3.0	0.8	275.7%

Sales

Frutarom's sales in the fourth quarter of 2004 totaled US$ 56.9 million, showing growth of 51.0% compared with the same quarter in 2003, when sales totaled US$ 37.7 million.

Sales Development in the Fourth Quarters of 2001 – 2004 (US$ million)
(Figures for 2001 and 2002 based on Israeli GAAP)



The growth in sales was influenced mainly by the following factors:

A. Continuing the merger of the Food Systems activity acquired from IFF in Switzerland, Germany and France with the Frutarom Group's global activity. The results of the activities acquired in Switzerland and Germany were consolidated from August 17, 2004 with Frutarom's results for 2004. The activity acquired in France is included in the results of Frutarom's activity as of November 2, 2004. The acquired activity contributed US$ 14.4 million to Frutarom's sales in the fourth quarter 2004.

B. Continuing the successful merger of Flachsmann in Switzerland and its subsidiaries in Canada and Denmark with the Frutarom Group's global activity.

C. The continued accelerated growth trend in recent years in the Flavors Division (which typically have higher margins compared to fine ingredients products), due to the consolidation and strengthening of activity in its subsidiaries worldwide.

D. Growth in the Fine Ingredients Division's sales, to which new, innovative high margin products developed in Frutarom's research and development laboratories contributed.

E. Continued consolidation and strengthening of Frutarom's global research, development, sales and marketing network, including emerging markets where the demand for processed food products grows at a rate higher than the global average.

F. The especially cold and rainy summer that hit Europe in 2004, where Frutarom has a significant presence, harmed the sales of some Frutarom customers, mainly in beverages and ice cream. Nevertheless, Frutarom was still able to succeed in growing all of its core activities.

Gross Profit

Gross profit grew 52.6% during the fourth quarter of 2004 to reach US$ 20.2 million compared with US$ 13.3 million in the same quarter in 2003. This increase is the result of the growth in activity turnover due to sales growth and the acquisition of the Food Systems activity from IFF.

Selling, Marketing, Research and Development, Administration and General Expenses

Selling, marketing, research and development, administration and general expenses totaled US$ 15.9 million (28% of sales) in the fourth quarter of 2004 compared with US$ 12.0 million (31.9% of sales) during the same quarter in 2003. The growth in expenses is mainly the result of the growth in Frutarom's activity and the addition of the Food Systems activity acquired from IFF.

Operating Profit

During the fourth quarter of 2004, operating profit continued the growth trend of recent years, totaling US$ 4.3 million, a sharp growth rate of 246% compared with the same quarter in 2003. Parallel to the growing the operating profit, the growth trend in operating margin also continued, reaching 7.5% in the fourth quarter of 2004 compared with 3.3% during the fourth quarter of 2003.

Finance Expenses

Finance expenses for the fourth quarter of 2004 totaled US$ 0.55 million (1.0% of sales) compared with US$ 0.33 million (0.9% of sales) in the same quarter of 2003. The growth in financial expenses reflects the growth in the Company's debt in order to finance the acquisition of the Food Systems activity from IFF.

Profit Before Tax

Profit before tax grew 309% in the fourth quarter of 2004 to reach US$ 3.7 million (6.6% of sales) compared with US$ 0.9 million in the same quarter of 2003 (2.4% of sales).

Taxes on Income

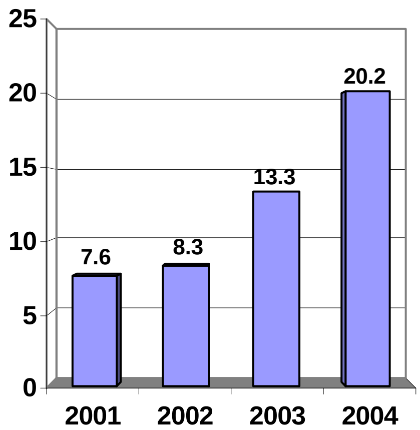
Taxes on income in the fourth quarter of 2004 totaled US$ 0.7 million (18.7% of profit before tax) compared with US$ 0.1 million in the same quarter in 2003 (11.5% of profit before tax).

Net Profit

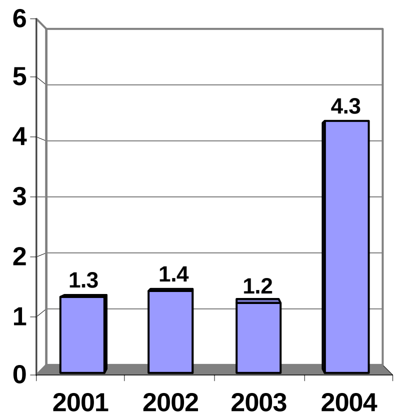
Net profit rose sharply by 275.7% during the fourth quarter of 2004 to reach US$ 3.0 million compared with US$ 0.8 million during the fourth quarter of 2003. Net margin also rose to reach 5.3% compared with 2.1% in the fourth quarter of 2003.

Profit Development in the Fourth Quarters of 2001 – 2004 (US$ million)
(All figures for 2001 and 2002 based on Israeli GAAP)

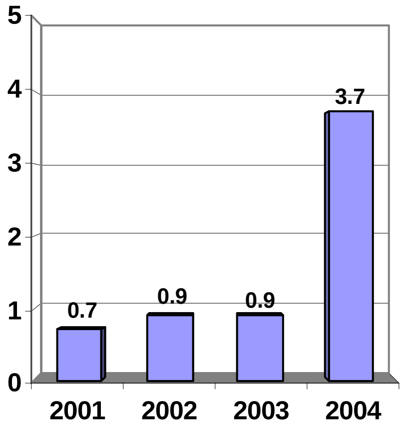
Gross Profit



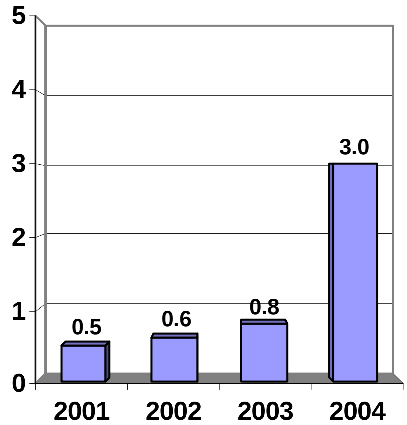
Operating Profit



Profit before Tax



Net Profit



Summary of profit and loss for the quarters (US$ million):

	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003
Sales	56.9	51.4	44.6	43.9	37.7
Gross profit	20.2	19.5	17.9	16.7	13.3
Selling, Marketing, R&D, Administration and General Expenses	15.9	12.9	11.6	11.8	12.0
Operating profit	4.3	6.5	6.3	4.9	1.2
EBITDA	6.7	8.9	8.4	7.1	2.5
Finance expenses	0.6	0.4	0.4	0.04	0.3
Profit before tax	3.7	6.1	5.9	4.9	0.9
Net profit	3.0	4.7	4.6	3.5	0.8

The Company's business is subject to seasonal fluctuations, generally with higher sales and profitability (due to product mix) in the first half of a given year and lower sales and profitability in the second half of a given year (particularly the fourth quarter). A substantial portion of the Company's products are used by its customers in the manufacture of beverages and dairy products such as soft drinks, ice cream and yogurts, for which demand generally increases markedly during the summer months. As a result, sales of certain flavors and fine ingredients produced by Frutarom rise in the first half of the year, as manufacturers of beverages and dairy products re-stock their inventories and increase production in advance of rising demand during the summer months.

Sales of the Company's products and margins generally decrease in the third quarter as the summer ends and further decrease in the fourth quarter as the weather cools and many of Frutarom's customers reduce production and inventory levels in advance of the year end and the holiday season.

The impact of seasonality on the Company's results has steadily decreased in recent years as the Company has increased its sales of products such as savory flavors, functional food ingredients and natural pharma/nutraceutical extracts, which generally have lower seasonality in demand.

Financial Status

Total assets on December 31, 2004 amounted to US$ 213.7 million compared with US$ 140.6 million at December 31, 2003.

The Company's current assets totaled US$ 104.0 million compared with US$ 72.9 million at the end of 2003.

Fixed assets minus accumulated depreciation and net other assets totaled US$ 102.0 million on December 31, 2004, compared with US$ 62.5 million at the end of 2003.

The growth in overall assets and particularly in current assets resulted mainly from the acquisition of IFF's Food Systems activity and the growth in activity turnover. Most of the increase in fixed assets derives from the acquisition of IFF's Food Systems activity and from investments made by the Company. The growth in current assets is principally the result of growth in the inventory and receivables balances due to the acquisition of IFF's activity and partially from the growth in activity requiring greater working capital.

Liquidity

During 2004, Frutarom achieved cash flow from operating activity of US$ 17.3 million compared with US$ 10.1 million in 2003 (the Food Systems activity acquisition from IFF was made with short term loans from Swiss banks; operating activity was financed by the Company's cash flow). The cash flow was used to reduce debt, make investments and increase the cash balance.

Sources of Finance

Sources of the Company's Equity

The Company's equity at December 31, 2004 totaled US$ 78.7 million (36.8% of the balance sheet) compared with US$ 59.6 million (42.4% of the balance sheet) on December 31, 2003. The growth in the Company's equity during 2004 derives mainly from the profit for the year.

Long Term Loans Including Current Maturities of Long Term Loans (Annual Average)

The average scope of long term credit from banks at December 31, 2004 totaled US$ 35.7 million. During the same period last year, the Company had US$ 36.7 million at its disposal.

Short Term Loans Excluding Current Maturities of Long Term Loans (Annual Average)

The average scope of short term credit from banks as at December 31, 2004 totaled US$ 17.6 million. During the same period in 2003, the Company had US$ 2.9 million at its disposal. The growth in short term loans at the Company's disposal is mainly the result of the acquisition of the Food Systems activity from IFF, which was financed with loans from banks in Switzerland.

Credit From Suppliers and Customers (Annual Average)

The average scope of credit from suppliers and other creditors in 2004 was US$ 36.6 million (US$ 29.0 million during 2003). During 2004, the Company granted average credit of US$ 36.8 million to receivables (US$ 28.9 million during 2003). Most of the growth in customer credit results from customer finance due to the acquisitions of the Food Systems activity from IFF and the growth in activity compared with 2003.

Disclosures about Market Risk

General

Through its two Divisions, the Company produces thousands of products intended for thousands of customers throughout the world, using hundreds of raw materials purchased from a wide range of suppliers worldwide. The Company is not significantly dependent on any of its customers, products or suppliers.

Responsibility for the Company's Market Risks Management

The Chief Financial Officer is responsible for managing market risks as relates to exchange rates and interest. The Managers of the two Divisions are responsible for managing market risks as it relates to changes in raw material prices. The Company's management and Board of Directors are updated on material changes in the Company's exposure to various risks, and conduct discussions as needed.

Description of Market Risk

A. Raw Material Price Risks

The Company is dependent on the supply of raw materials from third parties. Although the Company purchases raw materials from a very wide range of suppliers, with no single supplier representing more than 5% of its total raw material purchases, and although most raw materials purchased by the Company have more than one supplier and are for the most part widely available, there can be no guarantee that this will continue to be the case. Further, the price, quality and availability of many of the principal raw materials used by Frutarom mainly in the natural products field, are subject to fluctuations as a result of international supply and demand. Certain natural raw materials used by the Company are crop related, and the price, quality and availability of their supply could be adversely affected by, among other, unfavorable weather conditions. The Company does not normally make forward transactions and is exposed to price fluctuations of raw materials it uses in accordance with global price trends. The Company's Purchasing Department maintains an ongoing follow up on material prices. Selling prices of the Company's products are adjusted, as needed and to the extent possible, to significant fluctuations in raw material prices.

B. Currency Risks

The Company's sales worldwide are conducted mainly in US dollars, pounds Sterling, Swiss francs and in Euros to some Western European countries. The fact that raw material purchases for Frutarom's production are also conducted in various currencies reduces currency exposure. Currency exposure is reviewed as needed, on at least a quarterly basis. The Company does not generally take external hedging actions or use other financial instruments for protection against currency fluctuations.

C. Interest Risks

The Company's loans, short and long term, are linked to the US dollar, the pound Sterling and the Swiss franc (according to the activity in which the owing company is active), and bear variable Libor interest. The Company's policy is to not take protective steps against possible interest rises. The terms of some of the Company's loans allow it to repay loans and occasionally change the loan currency and interest rates based on its own judgment and changing market conditions.

As of the date of the balance sheet the Company did not hold any financial instruments.

The Company's Policy Regarding Risk Management

A. The Company attempts to reduce currency exposure, whether economic or accounting, by balancing liabilities and assets in each of the various currencies in which the Group operates.

B. The Chief Financial Officer is responsible for managing the Company's currency exposure. The Company's policy does not determine any limit, quantity-wise, for the exposure described above. The exposure level is checked on a regular basis by the Company's Accounting Department. The managers of the Divisions are responsible for managing market risk as it relates to changes in raw material prices. Ongoing follow up is conducted in this area and there is no limit, quantity-wise. Unusual occurrences, such as sharp devaluation trends in a target country or price change trends in important raw materials that may influence the Company's activity, are reported to the Board of Directors.

   In 2004 there were no changes to the risk management policy.

Supervision of Risk Management Policy and its Implementation

Discussions are conducted by the Company's management once each quarter on implementing the risk management policy as relates to currency exposure and interest. The Chief Financial Officer reports to the Board of Directors at the end of each year. Exposure to raw material prices is checked by the Purchasing Department and management of the Divisions on a regular basis, and the Board of Directors receives reports as the situation warrants.

In 2004 there were no significant deviations from the planned policy.

The Company does not use financial instruments for its protection.

Currency Exposure Report Based on Main Linkage Bases at December 31, 2004 (in US$ 000)

	USD	GBP	Euro	CHF	Other	NIS	Total US$
Assets							
Cash and equivalents	3,460	1,051	813	1,280	733	13	7,350
Customers	12,712	4,638	9,096	4,174	4,159	8,954	43,733
Other debtors	1,621	939	3,281	2,180	506	615	9,142
Inventory	23,240	5,477	4,177	10,875			43,769
Other assets	4,942			2,773			7,715
Fixed assets, net	24,482	7,087	10,259	54,855			96,683
Other assets, net	1,826	7,365	3,600	(7,443)			5,348
Total assets	72,284	26,556	31,227	68,693	5,398	9,582	213,740
Liabilities							
Bank credit			14,359	27,860		2,531	44,750
Suppliers	5,242	2,202	5,683	2,896	418	3,816	20,257
Other creditors	5,881	3,284	1,354	6,303	213	4,877	21,911
Bank loans	16,247	5,689		13,500			35,436
Employee retirement rights liabilities	898		6,383	1,221			8,502
Deferred taxes	3,095	1,145		(9)			4,231
Other, Long term							
Shareholders equity							78,653
	31,503	12,320	27,778	51,771	490	11,224	213,740
Net assets (Liabilities)	40,780	14,236	3,448	16,922	4,908	(1,642)	0

Events Following the Balance Sheet Date

In February 2005, the Company completed its offering, by issuing its shares and listing global depositary receipts on the London Stock Exchange official list. The net proceeds from the offering totaled US$ 75.8 million.

The Internal Auditor's Activity

The Company's Internal Auditor

Mr. Yoav Barak, CPA, was appointed internal auditor of the Company and began his work as internal auditor on January 17, 2005. Mr. Barak replaced Mr. Dov Gadot, CPA, who had served in the position until January 17, 2005. The internal auditor is not an employee of the Company.

Scope of the Internal Auditor's Position

With the replacement of the internal auditor, the scope of the internal auditor's position in the Company was expanded, in accordance with the Company's rate of expansion and growth. The internal auditor is employed on a two and a half days per week basis.

Audit Program

The audit program is prepared by the internal auditor in coordination with the president of the Company and the executive vice presidents and approved by the Audit Committee of the Board of Directors. The main considerations directing the program's preparation are based on subjects perceived as worthy of thorough analysis with the aim of locating faults, achieving efficiencies, ensuring the Company's assets are protected and that the Company's procedures and the local laws of the countries of operation are observed.

The annual audit program also includes follow up on the implementation of recommendations by the internal auditor and the Audit Committee by the Company's management.

Subsidiaries

The annual audit program also includes the subsidiaries that are material holding of the Company. The internal auditor conducts at least one audit per year at each significant overseas subsidiary.

Professional Standards Guiding the Audit's Performance

The work of internal auditing is conducted according to professional standards accepted in Israel and the world, which ensure professional, reliable and independent control. The audit reports record the findings of the audit and the documented facts.

Supervision of the Internal Auditor

The internal auditor reports to the Audit Committee of the Board of Directors and to the president of the Company.

Audit Committee Meetings during 2004

During 2004 four meetings were held, at which seven audit reports, one internal review, one procedure and other current control matters were presented and discussed.

The president of the Company, the executive vice presidents and the members of the Audit Committee received the audit reports and were present at all of the Audit Committee's meetings.

Independence and Status of the Internal Auditor

The internal auditor has free and independent access to the Company's information systems, including financial data. Replacement of the Company's internal auditor was a planned process, continuous and orderly, in cooperation between the current and former internal auditors.

Allotment of Shares and Distribution of Dividend

As part of a material private offering and a non-material private offering the Company performed in January 2004, the Company allotted 900,000 ordinary shares of the Company to three officers, including the president and CEO of the Company, Mr. Ori Yehudai, as part of a Senior Executive Share Plan.

As part of a non-material private offering carried out by the Company in June 2004, the Company allotted to an officer 150,000 non-transferable options in accordance with the instructions of section 102(b)(3) of the Internal Revenue Ordinance. Each option is exercisable into one share in the Company and in total for 150,000 shares in the Company.

In March 2004 the Board of Directors of the Company declared the distribution of a cash dividend in the amount of NIS 0.11 per share and a total of NIS 5,178,399. March 16, 2004 was set as the record date and the dividend was distributed on April 1, 2004.

On March 23, 2005, upon approval of the annual financial reports for 2004, the Board of Directors of the Company declared the distribution of a cash dividend in the amount of NIS 0.13 per share and a total of NIS 7,497,926.

Critical Accounting Estimations

Preparation of the financial reports of the Company in accordance with Israeli GAAP demands that the management prepare estimates and make assumptions that influence the amounts presented in the attached financial reports.

Below are presented the critical accounting estimations used in preparing the financial reports of the Company; during their consolidation the management was required to make assumptions regarding circumstances and events involving significant uncertainty. In using its judgment to determine these estimates the management of the Company bases itself upon past experience, various facts and on reasonable assumptions in accordance with the suitable circumstances for each estimate. The actual results may be different from the management's estimates. As to the general material accounting estimates used in preparing the financial reports of the Company, refer to note 1 to the attached financial reports.

A. Recognition of Income

Income from the sales of products, following deduction of returns and discounts given, are included in the financial reports when the ownership and the risks pass to the customer (generally at the time of shipment to the customer). When the income is recognized, the Company performs estimates regarding anticipated returns and turnover discounts given to certain customers and presents the stated income net of the amounts estimated. Following is a brief description of the estimates used by the Company when presenting the income item in profit and loss reports and certain amounts within the framework of current liabilities in the balance sheet, and how they were determined:

The Company provides for anticipated returns of goods in accordance with the estimates based on the Company's procedures, historic data reflecting the percentage of returns to the total sales turnover regarding each type of product, and the quantity of products returned damaged in relation to those returned to inventory for repeat sale.

Discounts to customers, the right to which is dependent on the customer's satisfying a minimal purchase turnover (quantitative or financial), are included in the financial reports, relatively, in accordance with the purchase turnover made by customers during the chosen period, as long as it is probable that the goals will be achieved and the amount of the discount can be reasonably assessed. The estimate of the discount amount is based, among others, on past experience with the specific customer and the sales turnover expected during the balance of the period. Each year, the management of the Company reviews historic data regarding product returns and the discounts given to customers and updates the relevant estimates as needed and in accordance with the circumstances in that year.

B. Reserve for Doubtful Debts

The reserve for doubtful debts is determined in a specific manner for debts whose collection is doubtful, in accordance with the management's estimates as based on the size of the debt and data on the business status of the customer.

C. Depreciation and Amortization Policy

Most of the non financial assets of the Company are comprised of buildings, machinery and equipment as well intangible assets such as knowhow, customer relationships and goodwill. The Company amortizes the intangible assets over the period of the lifespan as detailed in note 1 of the financial reports. In determining depreciation and amortization rates, management bases its estimate on the lifespan of each item, and in accordance with the Company's collective past experience of similar assets.

D. Asset Deterioration

In accordance with accounting standard number 15 of the Israeli Standards Institute, at each balance sheet date the Company reviews whether events have occurred or circumstances have changed that point to any deterioration in one or more of the cash yielding units to which this standard applies. The Company reviews whether the amount for which it is presented in the unit can be recouped from the cash flows expected from this unit and to the extent necessary, make provision for deterioration, up to the amount that can be recouped. In determining the cash flow estimates the Company bases itself upon its past experience, taking into consideration the situation in the market at the time of the review.

E. Open Claims and Liabilities

The Company is a party to claims and other pending liabilities that are raised from time to time against the Company and its subsidiaries, for which the Company does not always have reserves or other insurance coverage. When deciding whether to make a reserve against the claim or pending matter as stated, the Company bases itself on the professional opinions it receives from legal advisors and on estimations made by the management of the Company regarding possible exposure based on an estimate regarding the probability that the Company has to defend itself against these claims and pending liabilities.

Acquisition and Merger of IFF Activity

During the second half of 2004, Frutarom completed the acquisition of the European Food Systems business of IFF, through its subsidiaries in Switzerland, Germany and France. The total acquisition price was Eur 30.5 million (approximately US$ 38.0 million).

The acquired activity develops, produces and markets specialty compounds of fruit and other natural products (Food Systems) used as flavor and fragrance materials in a wide range of food products such as dairy (yogurt, ice cream), sweet and savory bakery and confectionery. The acquired activity includes two production plants in Switzerland and Germany, as well as marketing, sales and research and development activities in Switzerland, Germany and France.

The activity acquired includes the Food Systems activity of IFF Switzerland and IFF Germany which were acquired on August 17, 2004 at a purchase price of Eur 30.0 million. On October 29, 2004 the Company completed the acquisition of the Food Systems activity of IFF France for Eur3.5 million. The acquisition price is subject to an adjustment mechanism based on the net book value of the inventory, the fixed assets and the liabilities assumed by Frutarom as at August 18, 2004 (relative to Switzerland and France) and at October 29, 2004 (relative to France) compared with their value on December 31, 2003. After the adjustments the purchase price for the acquisition of IFF Food System activity in Switzerland and Germany was Eur 28 million (US$ 35 million) and in France, Eur 2.5 million (US$ 3 million). In addition, the acquisition agreement determines an earn out mechanism according to which the acquisition price may increase or decrease by up to Eur 3.5 million based on the results of the acquired activity in 2005 and 2006.

Acquiring the European Food Systems activity of IFF significantly expanded the Company's food and beverage customer base, geographic reach and product portfolio.

Upon completing its acquisition of the Food Systems activity in France, Frutarom implemented a reorganization plan that included the transfer of the production activity conducted by IFF in France to Frutarom's food systems production sites in Switzerland and Germany with the aim of reducing costs and improving production efficiency by integrating sales and marketing and research and development teams and by integrating the production with a similar existing activity in England. With the completion of the reorganization process during the fourth quarter of 2004, the first step of integrating the food systems activity with Frutarom's existing activity ended and the second stage, of extracting the many cross selling possibilities in the acquisition began.

Directors with Accounting and Financial Expertise

In accordance with the instructions of the Israeli Securities Authority, the Company's Board of Directors has determined that the minimum number of directors with accounting and financial expertise will be set at two. This number takes into account the character of the Company's activity, its complexity and size. The Board believes that this number will enable it to meet its obligations according to law and the Company's Articles of Association, and especially relating to its responsibility to check the Company's financial status and to prepare and approve the financial reports.

The directors with accounting and financial expertise are:

Dr. John Farber – Dr. Farber has served as Chairman and as a member of the board of directors of Frutarom since 1996. He is also Chairman of ICC Industries, the Company's principal shareholder, and a member of the boards of directors of various subsidiaries of ICC Industries. Dr. Farber holds a Ph.D. in polymer chemistry from Polytechnic Institute of Brooklyn, New York.

Mr. John Oram – Mr. Oram has served as a member of the board of directors of Frutarom since 1996. He is also President of ICC Industries Inc., and a member of the boards of directors of various subsidiaries of ICC Industries. Mr. Oram, a fellow of the Institute of Chartered Accountants in England and Wales, qualified in 1967.

Mr. Uzi Netanel – Mr. Netanel has served as an external director on the board of directors of Frutarom since November 2001. Mr. Netanel is the chairman of MLL Software &Computers Industries Ltd. and the chairman of the executive committee of Carmel Olefins Ltd. He is also a member of the boards of directors of Israel Oil Refineries Ltd., Kefar HaMaccabia Ltd. and Caesarea Vardinon Textiles Ltd. Mr. Netanel previously served as Chairman of Discount Capital Markets and Investments Ltd. until August 2001. In addition, Mr. Netanel served as the chairman of Poliziv Plastics Company (1998) Ltd. and the managing director and CEO of Rogosin Enterprises Ltd. Mr. Netanel was a partner in Fimi Fund from 2001 to 2003.

Mr. Gil Leidner – Mr. Leidner has served as an external director on the board of directors of Frutarom since August 2001. He is also Chairman of the Investment Committee of Phoenix Insurance Company Ltd. and a member of the boards of directors of New Koppel Ltd., Telder Ltd. And R.S.L. Electronics Ltd. Mr. Leidner was President of Goren Capital from 2001 until 2004. Mr. Leidner served as Deputy Accountant General of the Ministry of Finance, the State of Israel, between 1989 and 1992 and as President of M. I. Holdings between 1992 and 1996. Mr. Leidner holds an LL.B. and an MBA from Tel Aviv University.

Reconciling Accounting Principles Generally Accepted in Israel to IFRS

A. Commencing February 2005, the Company's GDRs are quoted in the official list of the London Stock Exchange. The financials statements submitted by the Company to the UKLA and the London Stock Exchange are prepared in accordance with International Financial Reporting Standards ("IFRS") and the financial statements submitted by the Company to the TASE and the Israeli Securities Authority are prepared in accordance with Accounting Principles Generally Accepted in Israel ("Israeli GAAP"). There are several material differences between Israeli GAAP and IFRS. Set forth below are the main differences between Israeli GAAP and IFRS:

1. General

The Company adopted, for the first time, in its financial statements as of December 31, 2003, the IFRS, in compliance with the transition provisions of IFRS 1. Under those provisions, the Company applied all IFRS that were in effect as of date of adoption to all reporting periods, commencing in the date of transition – January 1, 2002.

As part of the preparation of the IFRS financial statements, the Company early adopted the following International Financial Reporting Standards:

- IFRS 1 – First Time Adoption of IFRS.
- IFRS 2 – "Share-Based Payments" – commencing January 1, 2004.
- IAS 21 (R) – "The Effect of Changes in Exchange Rates of Foreign Currency".

2. Purchase method of accounting

Through March 31, 2004, the Company accounted for business combinations in accordance with IAS 22; as from that date, the Company gradually applies in accordance with transition provisions that were set, the provisions of IFRS 3 "Business Combinations".

Accordingly, the following differences arise:

(a) Concerning Acquisitions made before March 31, 2004

Negative goodwill has arisen on those acquisitions. As a rule, the negative goodwill is determined similarly under Accounting Principles Generally Accepted in Israel and under IFRS. However, under Israeli GAAP, the negative goodwill is allocated to non-monetary assets (mainly fixed assets and inventory) in proportion to their fair values and carried to income when such assets are realized or depreciated.

Under IAS 22, that portion of negative goodwill that relates to expectations of future losses and expenses that are identified in the acquirer's plan for the acquisition is recognized as income in the income statement when the future losses and expenses are recognized. The remaining negative goodwill (not exceeding the fair value of non-monetary assets) is recognized as income on a systematic basis over the remaining weighted average useful life of the identifiable acquired depreciable/amortizable assets (not including inventory). As a result of the above, the time or rate of charging the negative goodwill to Company's results of operations varies between the two reporting systems.

The amortization of the negative goodwill as described above will continue until December 31, 2004; under the transition provisions of IFRS 3, the balance of goodwill that has not yet been amortized as of that date (net of the related tax effect) will be charged directly to company's retained earnings as of January 1, 2005; this balance amounts to a total of $ 7.7 million. As from January 1, 2005, goodwill ceases to be amortized.

(b) Concerning Acquisitions made after March 31, 2004

Under the provisions of IFRS, negative goodwill (relating to purchases made after March 31, 2004) is no longer amortized, but is subject to annual impairment test, (or tested for impairment at an earlier stage, in cases where there are indications that impairment has occurred); negative goodwill is carried directly to Company's results of operations. Under Israeli GAAP, goodwill is amortized over its estimated useful life, for a period not exceeding twenty years.

3. Senior Employees Share Compensation

Under Israeli GAAP, and as is the practice in the Company, companies are not required to measure and record notional compensation expense in respect of securities granted to employees, excluding expenses involving cash outflow from the Company. Through December 31, 2003, the Israeli GAAP relating to this issue did not vary from the provisions of IAS 19. Commencing January 1, 2004, the Company has elected to early adopt IFRS 2 – "Share-Based Payments", for the purpose of implementing IFRS. Accordingly, as from that date, the Company measures and records notional compensation expenses relating to the grant of shares and options to employees, based on the fair value of the shares and options. These financial statements (under Israeli GAAP), do not reflect the notional compensation relating to the grant of shares and options as above, except in cases where the grant as above involved cash outflow from the Company.

B. Set forth below is the effect of the material differences between Israeli GAAP and IFRS, as described above, on the consolidated net income data, the net income per share and on shareholders equity, for each of the years ended 31.12.2003 and 31.12.2004:

1. Results of operations:

	Year ended December 31 ($ in thousands)	
	2004	2003
Consolidated net income for the year as reported in accordance with IFRS	15,756	8,034
The effect of accounting treatment in accordance with Israeli GAAP on the following items:		
Adjustment in respect of the time and rate of charging negative goodwill to results of operations	247	994
Amortization of goodwill	(51)	
Payroll expenses – charging of compensation in respect of grant of options and shares to employees	2,424	
Other adjustments	112	103
Tax effect relating to the above Adjustments	(27)	(181)
Deferred taxes	(129)	(35)
Consolidated net income for the year, in accordance with Israeli GAAP	18,332	8,915
Net income per share – in dollars:		
Basic and diluted	0.39	0.21

2. Shareholders' equity

	December 31 ($ in thousands)	
	2004	2003
Shareholders' equity as reported in accordance with IFRS	78,653	59,625

The effect of accounting treatment in accordance with Israeli GAAP on the following items:		
Adjustments related to allocation of negative goodwill and charging it to results of operations	1,174	880
Amortization of goodwill	(51)	
Other adjustments	197	49
Deferred taxes	(96)	29
Shareholders' equity, as reported in accordance with Israeli GAAP	79,877	60,583

C. Classification of items in the financial statements:

The preparation of financial statements in accordance with IFRS also affects the classification of certain items in the financial statements. The main effect on the balance sheet concerns the classification of the negative goodwill balance, in accordance with IFRS, as a negative item under "other assets", the classification of all deferred taxes under the long-term balance sheet items, and the presentation of capitalized lease fees as prepaid expenses. Under Israeli GAAP, negative goodwill is amortized directly from the non-monetary assets to which it is allocated, deferred taxes are classified as short-term items in case that current tax assets or liabilities have been created and the capitalized lease fees are included under fixed assets.

The main effect on the statement of income concerns the classification of other income and expenses, which should be taken into account (under IFRS) when determining the income from group operations.

Under IFRS, bank overdrafts are included in the statement of cash flows under cash and cash equivalents. Under Israeli GAAP, the definition of cash and cash equivalents for the purpose of presenting them in the statement of cash flows is identical to their definition for the purpose of presenting them in the balance sheet.

Events Following the Balance Sheet Date

On February 8, 2005, the Company completed an offering by way of issuing shares and listing global depositary receipts ("GDRs") on the London Stock Exchange Official List ("Offering"). As part of the Offering the Company offered 10,000,000 shares (in the form of shares and GDRs wherein one GDR represents one share). The shares were sold at the price of NIS 33.5 per share and the GDRs were sold at a price of US$ 7.63 per GDR (the "Offer Price"). The net proceeds received by the Company (minus commission to the underwriters and other expenses related to the Offering totaled at US$ 4.9 million) totaled to approximately US$ 71.4 million.

As part of the Offering, ICC Handels AG of the ICC Group (controlling shareholder in the Company) sold 2,000,000 shares in the Company at the Offer Price.

On February 16, 2005, UBS advised the Company and ICC Handels AG on behalf of the underwriters of the Offering of the exercise of the over-allotment option given by the Company and ICC Handels AG to acquire up to an additional 1,200,000 shares in the Company at the Offer Price. Upon exercise of the over-allotment option the Company issued an additional 600,000 shares and 600,000 existing shares were sold by ICC Handels AG.

Following the exercise of the over-allotment option, the total size of the offering is of 13,200,000 shares in the Company, of which 10,600,000 were sold by the Company and 2,600,000 by ICC Handels AG. The proceeds received from the exercise of the over-allotment option totaled to US$ 4.6 million. The net proceeds received by the Company (minus commission to the underwriters and other expenses related to the Offering totaled to US$ 0.2 million) grew by US$ 4.4 million and totaled to US$ 75.8 million.

On March 23, 2005, upon approval of the annual financial reports, the Board of Directors of the Company decided to distribute a cash dividend in the amount of NIS 0.13 per share for an overall total of NIS 7,497,926.

There were no other significant events following the balance sheet date.

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

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

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Dr. John J. Farber
Chairman of the Board

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Ori Yehudai
President & CEO
Member of the Board

March 23, 2005