

FRUTAROM INDUSTRIES LTD.
DIRECTORS REPORT TO THE SHAREHOLDERS
FOR THE PERIOD ENDING JUNE 30, 2005¹

General

Frutarom Industries Ltd. ("Frutarom" or "the Company"), a global company, was established in 1933 and became a public company in 1996 with the registration of its shares for trade on the Tel Aviv Stock Exchange. In February 2005, the Company's Global Depository Receipts were listed on the London Stock Exchange Official List. Frutarom develops, produces and markets flavors and fine ingredients used to produce food and beverages, flavors and fragrances, pharma/nutraceuticals, personal care and other products. Frutarom operates production facilities in Europe, North America, Israel and Asia, and produces, markets and sells over 14,000 products to more than 3,500 customers in more than 100 countries. Frutarom operates two divisions: the Flavors Division and the Fine Ingredients Division.

In recent years Frutarom has implemented a strategy for achieving rapid, above-industry average growth, through both internal growth and 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. 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, where growth rates are higher than the global average. Frutarom offers its customers a wide product range comprised mostly of natural and innovative, value-added products such as natural functional food ingredients, and continues to invest substantial resources in the Company's research and development activities. As part of this strategy, during the second quarter of the year Frutarom completed the acquisition of A.M. Todd's natural extracts activity. Frutarom's management is constantly seeking and evaluating new potential strategic acquisitions.

During the second quarter of 2005, Frutarom continued its trend of increased sales, profitability and profits for the twenty-third consecutive quarter. The consistent growth in the core activities of the two Divisions is an important element in the implementation of Frutarom's growth strategy. Frutarom's sales for the second quarter of 2005 totaled US\$ 67.1 million, growing 50.5% compared with the same quarter of 2004. Gross profit for the period rose 52.6% to reach US\$ 26.9 million, compared with US\$ 17.6 million in the same quarter of 2004. Operating profit rose sharply by 91.1% to US\$ 11.6 million, compared with US\$ 6.1 million in the same quarter of 2004. Operating margin rose to 17.2% compared with 13.6% for the same quarter of 2004. Net profit grew by 86.9%, reaching US\$ 8.4 million compared with US\$ 4.5 million in the same quarter of 2004, and net margin reached 12.5% compared with 10.1% in the same quarter of 2004. Profit per share also rose during the second

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

quarter of the year and reached US\$ 0.15 compared with US\$ 0.10 during the second quarter of 2004.

The cash flow from current activities achieved by Frutarom during the second quarter of 2005 totaled US\$ 8.2 million compared with US\$ 4.7 million in the second quarter of 2004. The cash flow was used during the quarter mainly to finance investments in fixed assets and to reduce the Company's loans balance.

Frutarom's sales for the first half of 2005 totaled US\$ 131.8 million, growing 49.0% compared with the first half of 2004. Gross profit for the period rose 49.9% to reach US\$ 51.9 million, compared with US\$ 34.6 million in the same half of 2004. Operating profit rose 86.1% to US\$ 20.8 million, compared with US\$ 11.2 million in the first half of 2004. Operating margin rose to 15.8% compared with 12.7% for the first half of 2004. Net profit grew sharply by 88.6%, reaching US\$ 15.2 million compared with US\$ 8.1 million in the first half of 2004, and net margin also rose, to reach 11.5% compared with 9.1% in the first half of 2004. Profit per share also rose during the first half of the year and reached US\$ 0.28 compared with US\$ 0.17 during the first half of 2004.

The cash flow from current activities achieved by Frutarom during the first half of 2005 totaled US\$ 13.6 million compared with US\$ 8.4 million in the first half of 2004.

The London offering carried out by the Company during February 2005, by way of issuing GDRs on the London Stock Exchange Official List, improved Frutarom's equity structure (the net proceeds totaled US\$ 75.8 million), contributes to its positioning as a global company, with leading institutional investors in the USA, UK and throughout the world.

Following the capital raising and the first half profit, Frutarom's equity as at June 30, 2005 totaled US\$ 168.3 million (71.1% of the balance sheet), compared with US\$ 67.4 million as at June 30, 2004 (46.5% of the balance sheet). The growth in equity enables Frutarom to leverage its strong equity structure in order to execute future strategic acquisitions in accordance with the rapid growth strategy implemented by the Company in recent years.

The continuous growth in operating and net profit and profitability seen in recent years derive mainly from the rapid expansion in Frutarom's activity resulting from organic growth in core activities of both the Flavors and Fine Ingredients Divisions, and the successful integration of activities acquired in recent years. The ongoing improvement in product mix through steady growth in the proportion of Frutarom's Flavors Division sales (which typically have higher margins than Fine Ingredients Division products) in Frutarom's overall sales, also contributed to the improvement in net profit. Flavors Division sales reached 66.5% of total sales in the second quarter of 2005, compared with 53.1% in the second quarter of 2004 and 65.4% in the first half of 2005 compared with 56.4% for the entire year of 2004. The Fine Ingredients Division, which is focusing on developing and introducing new, innovative and value-added products with a higher margin, also contributed to the growth in sales and the improvement in product mix, net profit and margins. Alongside the growth in activity in recent years, Frutarom has maintained a policy of closely controlling expense levels, which contributed to the increase in profitability and profit.

Summary of the Company's Activity

Frutarom operates in the global flavors and fine ingredients markets. In the flavors market, Frutarom is active in the segments of flavor compounds and food systems. In the fine ingredients market, Frutarom operates mainly in the segments of natural flavor extracts, natural functional food ingredients, natural pharma/nutraceutical extracts, specialty essential oils, unique citrus products and aroma chemicals.

Based on the data published by SRI Consultants, Frutarom estimates that sales in 2003 in the markets in which it operates totaled US\$ 14.7 billion (excluding sales of natural functional food ingredients outside of the United States and Europe and sales of pharma/nutraceutical extracts) and that global sales in the flavor and fine ingredients markets in which Frutarom operates will grow at an annual rate of between 2% and 4% from 2005 to 2008, although the growth rate is expected to be significantly higher in certain emerging markets such as Eastern Europe, Russia, China and India. In addition, the market for natural functional food ingredients is expected to grow at a higher rate of 9% in Europe and the United States.

The Company's activity is divided into two main divisions, each of which is a major field of activity:

- The Flavors Division develops, produces, markets and sells flavor compounds and Food Systems used mainly by manufacturers of food, beverages and other consumer products. Frutarom develops thousands of different flavors, most of which are tailor-made for specific customers, 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 since 2001 as a result of both organic growth and the successful integration of a number of strategic acquisitions. The internal growth in the Flavors Division's sales derives mainly from the Division's focus on both developed and emerging markets by providing superior service to global multinationals as well as mid-sized, local customers.
- The Fine Ingredients Division develops, produces, markets and sells natural flavor extracts, natural functional food ingredients, natural pharma/nutraceutical extracts, specialty essential oils and citrus products, aroma chemicals, natural gums and peptide building blocks. The Division's products 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 as a result of both internal growth and the successful implementation of several strategic acquisitions. The internal growth in the Fine Ingredients Division's sales is mainly the result of the development of new, innovative value-added products with higher than average margin and its focus on multinational, mid-sized and local customers worldwide.

The activities of Frutarom's two Divisions are greatly complementary and synergistic. This synergy is expressed in a number of main fields: (1) sales and marketing – one sales person handling each customer, and Fine Ingredients Division products that are intended for the food and beverage market are sold through the Flavors Division's sales force; (2) research and development – the knowhow and familiarity of the Flavors Division's team with the needs of the food and beverage market enable the Fine Ingredients Division to develop and produce new and innovative products for the

food and beverage industry; (3) operations – many of Frutarom's production sites are jointly utilized by the Flavors Division and the Fine Ingredients Division; (4) fine ingredients – although the majority of fine ingredients produced by the Company are sold to third parties, some specialty fine ingredients are developed and reserved solely for the Flavors Division to produce certain unique flavors, giving Frutarom a competitive advantage.

Frutarom will continue to invest considerable efforts and resources in successfully implementing the strategy of rapid growth it has successfully implemented in recent years. The strategy combines rapid internal growth of the more profitable core activity at higher than average rates for the industry, with strategic acquisitions of companies, knowhow and activities in fields in which the Company is active, in order to strengthen its positioning as one of the leading global companies in the field of flavors and fine ingredients.

Results of Activity in the Second Quarter and First Half of 2005

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

	2005	2004	Change (%)
Sales	67.1	44.6	50.5%
Gross profit	26.9	17.6	52.6%
R&D, Selling, Administration, General and Other expenses	15.4	11.6	32.4%
Operating profit	11.6	6.1	91.1%
EBITDA	13.7	8.2	66.7%
Profit before tax	11.4	5.7	100.4%
Net profit	8.4	4.5	86.9%

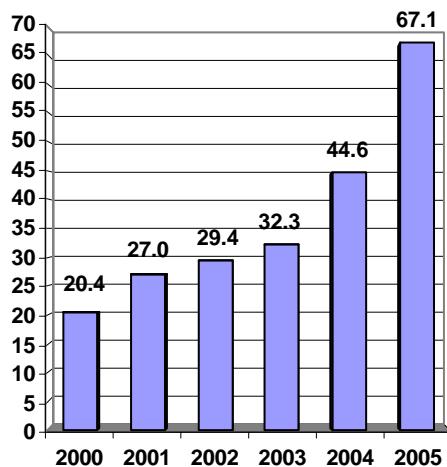
Following is a summary of the profit and loss report for the first half (US\$ million):

	2005	2004	Change (%)
Sales	131.8	88.5	49.0%
Gross profit	51.9	34.6	49.9%
R&D, Selling, Administration, General and Other expenses	31.1	23.4	32.6%
Operating profit	20.8	11.2	86.1%
EBITDA	25.5	15.5	64.2%
Profit before tax	20.5	10.8	90.4%
Net profit	15.2	8.1	88.6%

Sales

Frutarom's sales during the second quarter of 2005 totaled US\$ 67.1 million, showing growth of 50.5% compared with the second quarter of 2004, when sales totaled US\$ 44.6 million.

Sales Development in the Second Quarters of 2000–2005 (US\$ million)
(2000–2003 figures are based on Israeli GAAP)



Sales during the first half of the year totaled US\$ 131.8 million, up 49.0% compared with the first half of 2004.

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.
- B. The continued growth trend in recent years in the Flavors Division (which typically has higher margins compared to fine ingredients products), due to the consolidation and strengthening of activity in its subsidiaries worldwide.
- C. Growth in the Fine Ingredients Division's sales, mainly due to the introduction of new products, expansion and development of the global sales infrastructure and the successful integration and utilization of the synergy existing between its research and development and production sites worldwide.

Sales Breakdown by Fields of Activity in the Second Quarters of 2000–2005 (in % and US\$ million)

		2005	2004	2003	2002	2001	2000
Flavors Division	Sales	44.6	23.7	15.9	12.3	10.9	6.6
	%	66.5%	53.1 %	49.2 %	41.8%	40.4 %	32.2%
Fine Ingredients Division	Gross sales	22.2	19.7	15.3	15.9	15.1	12.6
	Interdivision sales	(1.2)	(0.8)	(0.6)	(0.5)	(0.4)	(0.3)
	Net sales	21.0	19.0	14.7	15.4	14.7	12.2
	%	31.3%	42.7%	45.4%	52.5%	54.6%	60.2%
Trade & Marketing	Sales	1.5	1.9	1.7	1.7	1.4	1.6
	%	2.2%	4.2%	5.4%	5.7%	5.1%	7.7%
Total sales		67.1	44.6	32.3	29.4	27.0	20.4

Sales Breakdown by Fields of Activity in the First Halves of 2000–2005 (in % and US\$ million)

		2005	2004	2003	2002	2001	2000
Flavors Division	Sales	86.3	45.4	28.6	23.2	20.0	13.4
	%	65.4%	51.3%	47.3%	41.1%	39.1%	31.7%
Fine Ingredients Division	Gross sales	44.3	40.8	29.4	30.9	29.0	26.5
	Interdivision sales	(2.0)	(1.4)	(1.1)	(0.8)	(0.7)	(0.7)
	Net sales	42.2	39.5	28.4	30.1	28.3	25.8
	%	32.1%	44.6%	46.9%	53.3%	55.3%	61.0%
Trade & Marketing	Sales	3.3	3.6	3.5	3.2	2.9	3.1
	%	2.5%	4.1%	5.8%	5.7%	5.7%	7.3%
Total sales		131.8	88.5	60.5	56.5	51.2	42.3

In recent years, the growth in the Flavors Division's sales, which typically generate higher margins than fine ingredients products, has increased as a proportion of Frutarom's total sales, reaching 66.5% of total sales in the second quarter of 2005 compared with 32.2% in the second quarter of 2000. The increase in the Flavors Division's portion of Frutarom's total activity in 2005 results from the rapid growth in recent years in its sales and the growth in this Division resulting from the inclusion of the Food Systems activity acquired from IFF during the second half of 2004.

Gross Profit

Gross profit grew 52.6% during the second quarter of 2005 to reach US\$ 26.9 million compared with US\$ 17.6 million in the second quarter of 2004, and gross profitability during the period reached 40.1% compared with 39.6% during the same period in 2004. During the first half of 2005, gross profit grew 49.9% to reach US\$ 51.9 million compared with US\$ 34.6 million during the first half of 2004, while gross profitability for the first half of 2005 reached 39.4% compared with 39.1% in the first half of 2004. This increase is the result of the growth in activity and sales in core activities and as a result of the acquisition of the Food Systems activity from IFF.

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

Selling, marketing, research and development, administration, general and other expenses totaled US\$ 15.4 (22.9% of sales) in the second quarter of 2005, compared with US\$ 11.6 million (26% of sales) during the second quarter of 2004. During the first half of the year, these expenses totaled US\$ 31.1 million (23.6% of sales) compared with US\$ 23.4 million (26.5% of sales) during the same period in 2004. The increase 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

Operating profit grew sharply by 91.1% during the second quarter of 2005 compared with the second quarter of 2004, totaling US\$ 11.6 million. During the first half of 2005, operating profit continued the growth trend of previous years to reach US\$ 20.8 million, up 86.1% compared with the first half of 2004.

Parallel to the growth in operating profit, the growth trend in operating margin also continued, reaching 17.2% during the second quarter of 2005, compared with 13.6% in the second quarter of 2004. During the first half of 2005 operating margin grew to 15.8% compared with 12.7% during the same period in 2004.

Finance Expenses

Finance expenses for the second quarter of 2005 totaled US\$ 0.2 million (0.3% of sales), compared with US\$ 0.4 million (0.8% of sales) in the second quarter of 2004. During the first half of 2005, finance expenses totaled US\$ 0.4 million (0.3% of sales), compared with US\$ 0.45 million (0.5% of sales) in the first half of 2004. The decline in finance expenses is due, among others, to the repayment of most of the Company's debts following its raising capital on the London stock exchange during the first quarter.

Profit before Tax

Profit before tax for the second quarter of 2005 grew 100.4% to reach US\$ 11.4 million (17% of sales), compared with US\$ 5.7 million (12.8% of sales) during the same period in 2004. During the first half of 2005, profit before tax grew 90.4% to reach US\$ 20.5 million (15.5% of sales) compared with US\$ 10.8 million (12.1% of sales) during the same half in 2004.

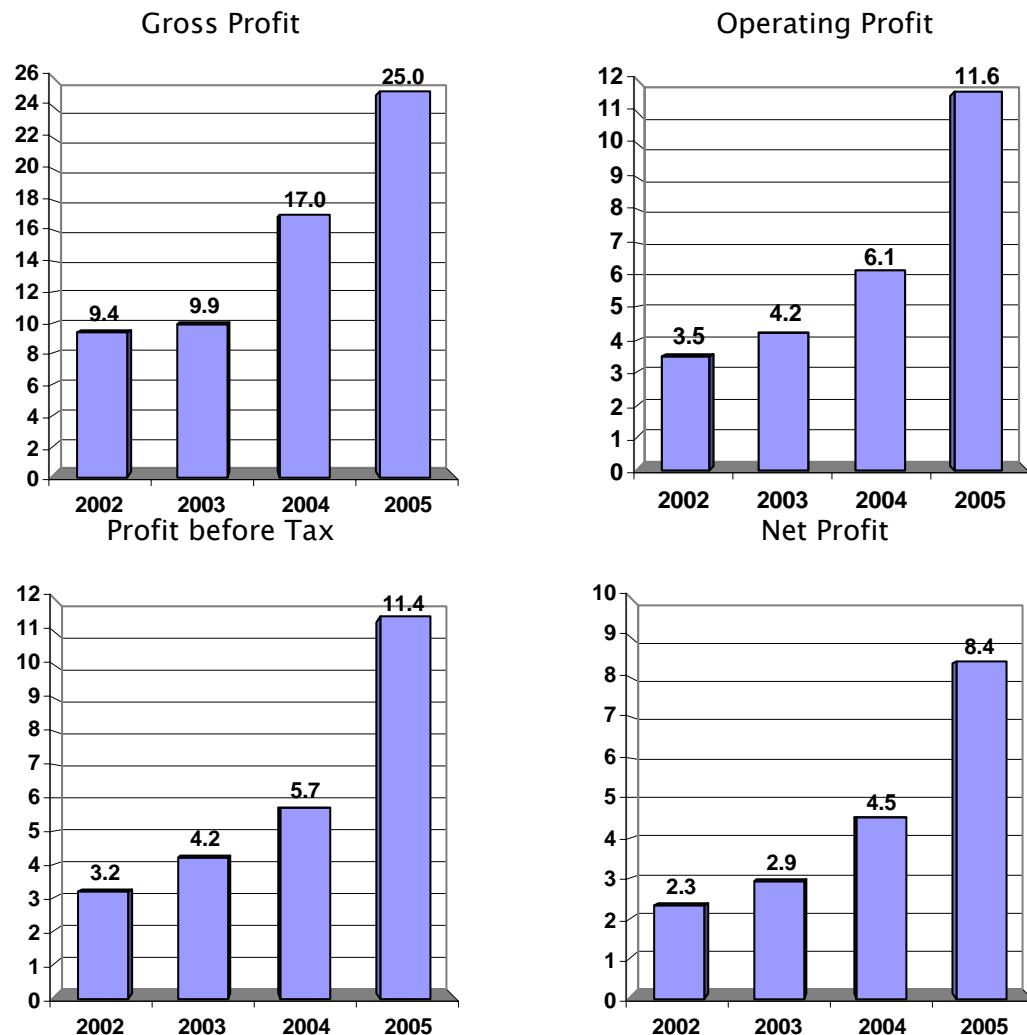
Taxes on Income

Taxes on income in the second quarter of 2005 totaled US\$ 3.0 million (26.5% of profit before tax) compared with US\$ 1.2 million (21.2% of profit before tax) during the same period in 2004. During the first half of 2005, taxes on income totaled US\$ 5.3 million (25.7% of profit before tax) compared with US\$ 2.7 million (25.0% of profit before tax) during the same period in 2004.

Net Profit

Net profit for the second quarter of 2005 rose by 86.9% to reach US\$ 8.4 million, compared with US\$ 4.5 million in the second quarter of 2004. Net margin also rose, reaching 12.5%, compared with 10.1% in the same quarter in 2004. During the first half of the year net profit grew sharply by 88.6% to reach US\$ 15.2 million compared with US\$ 8.1 million during the first half of 2004. Net margin rose to 11.5% compared with 9.1% during the same period in 2004.

Profit Development – Second Quarter – 2002–2005 (US\$ million)
(2002–2003 figures based on Israeli GAAP)



Summary of quarterly profit and loss (US\$ million):

	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004
Sales	67.1	64.7	56.9	51.4	44.6	43.9
Gross profit	26.9	25.0	20.2	19.5	17.6	17.0
Selling, Marketing, R&D, Administration, General and Other Expenses	15.4	15.7	15.9	12.9	11.6	11.8
Operating profit	11.6	9.3	4.3	6.5	6.1	5.1
EBITDA	13.7	11.8	6.7	8.9	8.2	7.3
Finance expenses	0.2	0.2	0.6	0.4	0.4	0.08
Profit before tax	11.4	9.1	3.7	6.1	5.7	5.1
Net profit	8.4	6.8	3.0	4.7	4.5	3.6

Frutarom'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. 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.

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, natural functional food ingredients and natural pharma/nutraceutical extracts. These products are intended for the pharma/nutra industries and generally have lower seasonality in demand.

Financial Status

Total assets on June 30, 2005 amounted to US\$ 236.8 million, compared with US\$ 144.9 million at June 30, 2004 and US\$ 213.7 million at December 31, 2004.

The Company's current assets totaled US\$ 127.8 million compared with US\$ 78.3 million at the end of the second quarter of 2004 and US\$ 104.0 million at December 31, 2004.

Fixed assets minus accumulated depreciation and net other assets totaled US\$ 102.7 million on June 30, 2005, compared with US\$ 61.3 million at the end of the same quarter of 2004 and US\$ 102.0 million at December 31, 2004.

The growth in overall assets, and particularly in current assets, resulted mainly from the acquisition of IFF's Food Systems activity, the London offering made in February 2005 and the growth in activity turnover.

Liquidity

During the second quarter of 2005, Frutarom achieved cash flow from operating activity of US\$ 8.2 million, compared with US\$ 4.7 million in the same quarter of 2004. The cash flow was used to finance the growth in working capital resulting from the growth in activity and to reduce the Company's loans balance. During the first half of 2005, Frutarom achieved cash flow from operating activity of US\$ 13.6 million compared with US\$ 8.4 million in the first half of 2004.

Sources of Finance

Sources of the Company's Shareholders Equity

Frutarom's shareholders equity at June 30, 2005 totaled US\$ 168.3 million (71.1% of the balance sheet) compared with US\$ 67.4 million (46.5% of the balance sheet) during the same quarter in 2004. The growth in the Company's shareholders equity during 2005 derives mainly from the US\$ 76 million in capital raised by the Company in February. The growth in profit also contributed to the growth in shareholders equity. A change in the US dollar exchange rate against other currencies that are the main activity currency for the autonomous subsidiaries influenced the "currency translation differences equity fund" and reduced the shareholders equity balance. This item does not affect the profit and loss and the cash flow.

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

The average scope of long term credit from banks totaled US\$ 9.3 million. During the same period last year, the Company had US\$ 36.4 million at its disposal.

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

The average scope of short term credit from banks totaled US\$ 1.3 million. During the same period of 2004, the Company had US\$ 1.8 million at its disposal.

Credit From Suppliers and Customers (Quarterly Average)

During the second quarter of 2005 the average scope of credit from suppliers and other creditors was US\$ 47.4 million compared with US\$ 34.7 million during the same quarter of 2004. During the second quarter of 2005, the Company granted average credit of US\$ 50.7 million to its cusotmers, compared with US\$ 34.2 million during the same quarter of 2004. Most of the growth in suppliers' and customers' credit results primarily from the growth in activity due to the acquisition of the Food Systems activity from IFF.

Disclosures about Market Risk

The Company's activity is characterized by extensive dispersal. Through its two Divisions, the Company produces thousands of products intended for thousands of

customers throughout the world, using thousands 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.

The Company operates in a multi-currency environment. 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. 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 risk 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.

Review of the Auditors' Work

In accordance with the instructions of the Israeli Securities Authority dated July 20, 2005, the Company expressed its principle consent to participating in the review. However, in light of the many questions relating to this review, including legal questions concerning the confidentiality obligations of the accounting firms to the Company, the Company will consider giving its final and binding consent, subject to the rules and conditions to be determined concerning the confidentiality and other issues.

Events Following the Balance Sheet Date

There were no significant events following the balance sheet date.

The Board of Directors of the Company held one meeting during the report period.

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

Dr. John J. Farber
Chairman of the Board

Ori Yehudai
President & CEO

August 14, 2005