FRUTAROM INDUSTRIES LTD.
DIRECTORS REPORT TO THE SHAREHOLDERS
FOR THE PERIOD ENDING DECEMBER 31, 2005[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, beverages, flavors and fragrances, pharma/nutraceutical, personal care and other products. Frutarom produces, markets and sells over 14,000 products 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, through both internal growth and strategic acquisitions. Frutarom focuses on large multinational companies as well as mid size and local companies, offering each customer the same superior service, tailored to the customer's unique needs. Frutarom concentrates on developed markets such as Western Europe and the United States, as well as emerging markets such as CIS, Eastern Europe and Asia, which are growing faster than the average global rate. 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. The Division's sales increased from US$ 39.2 million in 2001 to US$ 156.6 million in 2005. The growth was achieved by focusing on both developed and emerging markets by providing superior service to both multinational and mid sized, local customers, and the strategic acquisitions that were executed in recent years.

- 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, and natural gums and stabilizers. 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

[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.

significant growth in recent years, with sales increasing from US$ 57.6 million in 2001 to US$ 84.6 million in 2005. The growth in the Fine Ingredients Division's sales is principally the result of focusing on the development of new, innovative added value products; the large natural product portfolio that represents approximately 70% of the Division's sales; and the Division's focus on multinational and on mid sized customers, and the strategic acquisition which are major part of Frutarom growth strategy .

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

2005 was a good year for Frutarom. The Company continued its trend of growth in sales, profitability and profits for the sixth consecutive year. Frutarom continued establishing 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, and the activity of the European Food Systems acquired from International Flavors & Fragrances Inc. ("IFF") during the second half of 2004 were successfully integrated with Frutarom's existing activity. These acquisitions strengthen Frutarom's position, considerably expanding its multinational food, beverage and pharmaceutical customer base; geographic reach throughout the world (including entry to new 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). The acquisitions provide Frutarom with new possibilities and opportunities for cross-selling between the new products and customers added following the acquisitions and Frutarom's existing products and customers.

In June 2005, the Company signed an agreement to acquire the flavoring extracts business of the American company, A.M. Todd Botanical Therapeutics ("Todd"). Acquiring Todd's flavors extracts business strengthened Frutarom's flavors extracts business mainly in the American market. Immediately after the acquisition, the acquired activity was merged into Frutarom's existing activity at the Company's site in New Jersey, USA.

After the date of the balance sheet, on January 17, 2006, Frutarom signed an agreement to acquire 70% of the issued and paid share equity of GewurzMuhle Nesse GmbH and GewurzMuhle Nesse Gebr. Krause GmbH (together, referred to as "Nesse"). Nesse has been active since 1880 and today is an international group achieving high internal growth and employing about 120 people. Nesse develops, produces, markets and sells innovative, unique savory solutions that include savory flavors and specialty functional ingredients. This strategic acquisition is an additional milestone in implementing Frutarom's strategy for rapid growth. The acquisition strengthen the technological capabilities and product range that Frutarom offers its customers in the savory field, and contribute to strengthening and positioning Frutarom in both West and East Europe as a leading flavors supplier and allow for cross selling opportunities. The details of this acquisition appear in the section entitled, Events Following the Balance Sheet Date.

During February 2005 Frutarom raised capital by way of issuing ordinary shares and registering Global Depositary Receipts on the London Stock Exchange Official List. The net consideration for the offering received by the Company (net of underwriting commission and other expenses related to the offer, in the amount of US$ 5.1 million), totaled US$ 75.8 million. This offering added leading institutional investors throughout the world to Frutarom's shareholders, improved Frutarom's equity structure, supported Frutarom's position as a global company and gave Frutarom the means required to continue executing strategic acquisitions as part of implementing its rapid growth strategy. The Company reports its financial results to the London Stock Exchange according to International Financial Reporting Standards ("IFRS").

Frutarom's sales for 2005 totaled US$ 243.8 million, growing 23.9% compared with 2004, when sales reached US$ 196.8 million. Gross profit for 2005 rose 27.2% to reach US$ 94.5 million compared with US$ 74.3 million in 2004. Gross margin rose from 37.8% to 38.8%. Operating profit rose 53.3% to US$ 33.7 million compared with US$ 22.0 million in 2004. Operating margin rose to 13.8% compared with 11.2% in 2004. Net profit grew significantly by 70.4%, reaching US$ 26.8 million compared with US$ 15.8 million in 2004. Net margin was 11.0% of sales compared with 8.0% in 2004. Profit per share rose by 44% during 2005 and reached US$ 0.49 compared with US$ 0.34 during 2004 (despite the growth in the Company's issued share capital as a result of the capital raising and registration on the London Stock Exchange Main List in February 2005).

The cash flow from current activities achieved by the Company in 2005 was US$ 32.5 million compared with US$ 17.3 million in 2004. In addition, during the year the Company realized non operational assets (a plant in Canada and assets in Hungary acquired in 2003 as part of the Flachsmann acquisition) for approximately US$ 6 million. Additionally, in accordance with the adjustment mechanisms included in the acquisition agreement for IFF's Food Systems, receipts in the amount of US$ 4.6 million were received for the adjustment.

Frutarom's equity totaled US$ 177.8 million as at December 31, 2005, which is 76% of the balance sheet, compared with US$ 78.7 million as at December 31, 2004, which is 36.8% of the balance sheet.

Frutarom's sales for the fourth quarter of 2005 totaled US$ 52.6 million, decreasing 7.6% compared with the fourth quarter of 2004 and about 1.6% compared with the fourth quarter of 2004 when currency influences are deducted. Sales were influenced by the relatively weak period experienced by processed food manufacturers, mainly in Western Europe, the weakening of European currencies against the US dollar, and significant decline in sales of ArtChem products. Gross profit for the quarter declined 3.3% to reach US$ 19.6 million compared with US$ 20.2 million in the same period last year. Despite the decline in sales, the improvement in operating and net profits and profitability continued. Operating profit increased 16.4% to US$ 5.0 million (including one time profit of US$ 1.5 million from the IFF acquisition adjustment mechanism) compared with US$ 4.3 million during the same quarter in 2004. Operating margin reached 9.5% compared with 7.5% during the same period in 2004. Net profit rose by 60.8% to reach US$ 4.9 million compared with US$ 3.0 million in the fourth quarter of 2004. Net margin reached 9.3% compared with 5.3% in the same quarter of last year. Profit per share rose during the fourth quarter of the year and reached US$ 0.09 compared with US$ 0.06 during the fourth quarter of 2004 (despite the growth in the Company's issued share capital as a result of the capital raising and registration on the London Stock Exchange Main List in February 2005). The cash flow from current activities achieved by Frutarom during the fourth quarter of 2005 rose by 220% totaled US$ 5.6 million compared with US$ 1.8 million in the fourth quarter of 2004.

The increase in net profit seen in recent years derives, among other reasons, from the rapid growth in both the Flavors Division and the Fine Ingredients Division, 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 (the most profitable of Frutarom's activities), which has progressively increased (64.2% in 2005 compared with 56.4% in 2004, 48.8% in 2003 and 32.9% in 2000), also contributed to the improvement in net profit. 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 improvement in Frutarom's product mix and net profit. Alongside the growth in activity in recent years, Frutarom has maintained a policy of closely controlling growth of expense levels, which has contributed to the continuous growth 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 fine ingredients companies.

Results of Activity in 2005

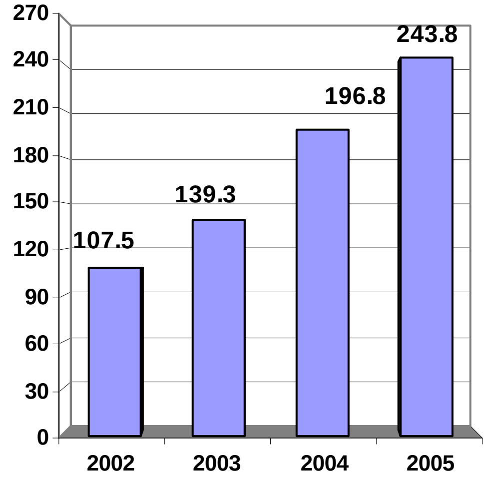
Following is a summary from the annual profit and loss report (US$ million):

	2005	2004	2003	Change (%) 2005 vs 2004
Sales	243.8	196.8	139.3	23.9%
Gross profit	94.5	74.3	49.9	27.2%
Selling, Marketing, R&D, Administration, General and Other expenses	60.8	52.3	37.3	16.2%
Operating profit	33.7	22.0	12.6	53.3
EBIDTA	42.8	31.1	17.5	37.8
Finance expenses	0.4	1.3	1.0	-69.1%
Profit before tax	33.3	20.7	11.6	61.3
Net profit	26.8	15.8	8.0	70.4

Sales

Frutarom's sales in 2005 totaled US$ 243.8 million, showing growth of 23.9% compared with 2004, when sales totaled US$ 196.8 million.

Sales Development in 2002 – 2005 (US$ million)



The following factors in particular 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. 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.

C. Utilization of the synergy and cross-selling possibilities among Frutarom's Divisions and between customers and products, both existing and those added as a result of the acquisitions made in recent years.

The growth in sales was to some extent offset by the following factors:

A. Relatively weak period in the processed food industry, mainly in Western Europe during the second half of 2005, together with the relatively cold and wet summer.

B. Weakening of the Western European currencies (in which most of Frutarom's sales are conducted) against the US dollar.

C. Significant erosion in selling prices of natural extracts and flavor compounds containing natural vanilla, due to the significant decline in the cost of raw materials required for their manufacture.

D. Significant decline in ArtChem sales due to very low usage of ArtChem products by the main customer. ArtChem produces raw materials in the field of peptides intended for the biotechnological pharmaceuticals industry, which is not a core activity of Frutarom.

Breakdown of Sales by Geographic Region

Most of the Company's sales are in Europe, North America, Israel, Asia and the Far East. In 2005, 58.8% of the Company's sales were in Europe, 12.4% in North America, 12.7% in Israel, and 10.2% in Asia and the Far East.

The following table sets forth the Company's sales in 2003, 2004 and 2005, broken down by geographic regions (US$ million):

	2005	2004	2003	Change (%) 2005 vs 2004
Europe	143.3	102.2	53.6	40.2%
North America	30.3	30.3	28.9	--
Israel	31.0	27.3	24.9	13.6%
Asia and Far East	24.8	24.4	23.1	1.6%
Other	14.5	12.5	8.8	16%
Total	243.8	196.8	139.3	23.8%

The significant growth in the Company's sales in Europe is the result of a combination of 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) and internal growth in core activities. As part of its strategy, Frutarom intends to grow the degree of its sales in North America through a combination of internal growth and strategic acquisitions. The internal growth in Frutarom's core activities in North America that was achieved in 2005 was adversely impacted by the significant decline in sales of ArtChem, which are not a core business.

Due to the global growth in Frutarom's activity, Israel's relative portion of the sales 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 small size of the Israeli market and the expected growth in Frutarom's global activity.

Breakdown of Sales by Fields of Activity in 2000-2005 (in % and US$ million)

The following table set forth the Company's sales from 2000 through 2005, broken down by field of activity:

		2000*	2001	2002	2003	2004	2005
Flavors Division	Sales	26.5	39.1	45.3	68.2	110.9	156.6
	%	32.9%	38.7%	42.2%	49.0%	56.4%	64.2%
Fine Ingredients Division	Sales	49	57.5	57.7	67.0	81.7	84.6
	%	60.9%	56.9%	53.7%	48. 0%	41.5%	34.7%
Trade & Marketing	Sales	6.3	5.6	6.2	6.5	6.8	6.3
	%	7.8%	5.6%	5.7%	4.7%	3.5%	2.6%
Inter Division	Sales	-1.3	-1.2	-1.7	-2.3	-2.6	-3.7
	%	-1.6%	-1.2%	-1.6%	-1.7%	-1.3%	-1.5%
Total sales		80.5	101.0	107.5	139.3	196.8	243.8

* Figures for 2000 are based on Israeli GAAP

In recent years, the Flavors Division's sales (whose products typically generate higher margins than fine ingredients products) as a proportion of Frutarom's total sales has progressively increased, reaching 64.2% of total sales in 2005 compared with 32.9% in 2000. The relative increase in the proportion of the Flavors Division's sales out of Frutarom's total sales in 2005 results mainly from the addition 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 2006. Alongside the growth in the Flavors Division, the relative proportion of the Fine Ingredients Division decreased in 2005 to 34.7% compared with 60.9% in 2000, in spite of the growth achieved in the Division's sales. The Trade & Marketing activity is not considered a core activity by Frutarom's management.

Gross Profit

Gross profit for 2005 grew 27.2% to reach US$ 94.5 million compared with US$ 74.3 million in 2004. Gross margin rose from 37.8% in 2004 to 38.8% in 2005. This increase is the result of the growth in sales, improvement to the product mix and the utilization process of the synergies and efficiencies in the Company.

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

Selling, marketing, research and development, administration, general and other expenses totaled US$ 60.8 million (24.9% of sales) in 2005 compared with US$ 52.3 million (26.6% of sales) during 2004. The growth in expenses is mainly the result of the growth in Frutarom's activity.

Operating Profit

Operating profit continued in 2005 the growth trend of recent years, totaling US$ 33.7 million, showing growth of 53.3% compared with 2004. Parallel to the growth in operating profit, the growth trend in operating margin also continued, reaching 13.8% compared with 11.2% in 2004.

Finance Expenses

Finance expenses for 2005 totaled US$ 0.4 million (0.2% of sales) compared with US$ 1.3 million (0.7% of sales) in 2004. The decrease in financial expenses results from the decrease in the scope of the average debt in 2005 compared with 2004, which decreased significantly following loan repayments from the capital raised in February 2005.

Profit before Tax

Profit before tax grew 61.3% in 2005 to reach US$ 33.3 million (13.7% of sales) compared with US$ 20.7 million in 2004 (10.5% of sales).

Taxes on Income

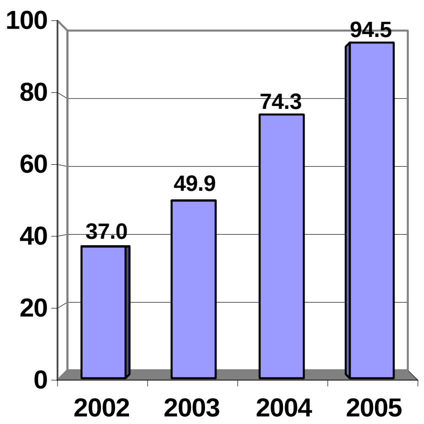
Taxes on income in 2005 totaled US$ 6.5 million (19.4% of profit before tax) compared with US$ 4.9 million in 2004 (23.8% of profit before tax). The rate of taxes on income declined due to the relative growth in profit in countries where the tax rate is lower than Frutarom's average tax rate, the decrease in the effective tax rate in Israel, and equity income from the sale of non operational assets in Canada.

Net Profit

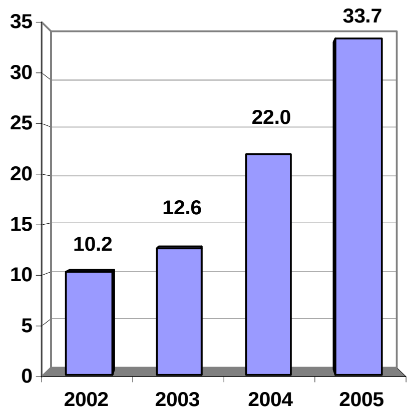
Net profit rose sharply in 2005 by 70.4% to reach US$ 26.8 million compared with US$ 15.8 million in 2004. Net margin also rose, reaching 11.0% compared with 8.0% in 2004.

Profit Development – 2002 – 2005 (US$ million)

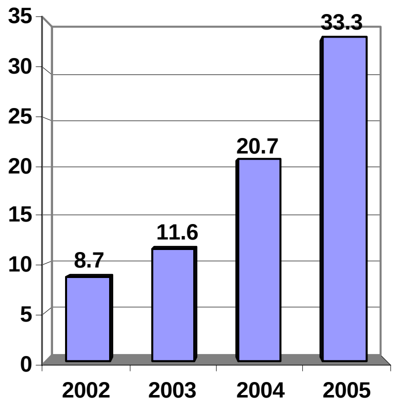
Gross Profit



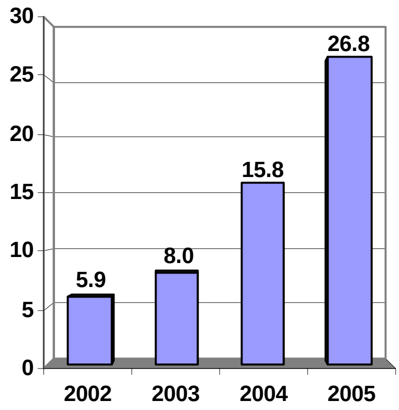
Operating Profit



Profit before Tax



Net Profit



Results of Activity during the Fourth Quarter of 2005

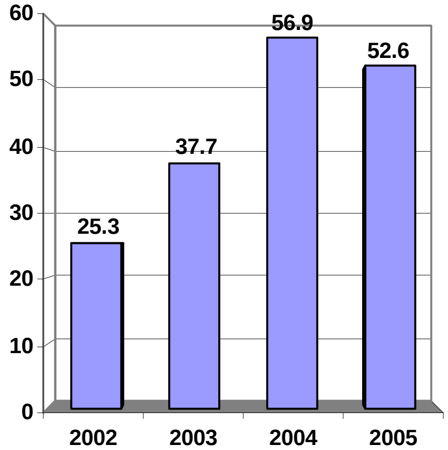
Following is a summary of the profit and loss report for the fourth quarter (US$ million):

	2005	2004	2003	Change (%) 2005 vs 2004
Sales	52.6	56.9	37.7	-7.6%
Gross profit	19.6	20.2	13.3	-3.3%
Selling, marketing, R&D Administration, General and Other expenses	14.6	15.9	12.0	-8.6%
Operating profit	5.0	4.3	1.2	16.4%
EBIDTA	7.1	6.7	2.5	6.5%
Financial expenses	--	0.6	0.3	--
Profit before tax	5.0	3.7	0.9	34%
Net profit	4.9	3.0	0.8	60.8%

Sales

Frutarom's sales in the fourth quarter of 2005 totaled US$ 52.6 million, showing a decline of 7.6% compared with the same quarter in 2004, when sales totaled US$ 56.9 million. When the influence of the strengthened dollar against the European currencies is deducted, the decline is about 1.6%.

Sales Development in the Fourth Quarters of 2002 – 2005 (US$ million)
(Figures for 2002 based on Israeli GAAP)



The sales were influenced mainly by the following factors:

A. Continuation of the relatively weak period in the processed food industry, mainly in Western Europe during the second half of 2005, together with the relatively cold and wet summer.

B. Weakening of the European currencies (in which Frutarom conducts most of its sales) against the dollar.

C. Significant recent erosion in selling prices of natural extracts and flavors produced from natural vanilla due to a substantial decrease in the prices of raw materials used for their production.

D. Significant decline in ArtChem sales due to very low usage of these products by the main customer. ArtChem produces raw materials in the field of peptides intended for the biotechnological pharmaceuticals industry, which is not a core activity for Frutarom.

Gross Profit

Gross profit decline 3.3% during the fourth quarter of 2005 to reach US$ 19.6 million compared with US$ 20.2 million in the same quarter in 2004. This decrease is mainly the result of the decrease in sales.

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

Selling, marketing, research and development, administration, general and other expenses totaled US$ 14.6 million (27.7% of sales) in the fourth quarter of 2005 compared with US$ 15.9 million (28.0% of sales) during the same quarter in 2004.

Operating Profit

During the fourth quarter of 2005, operating profit increased 16.4% to US$ 5.0 million compared with US$ 4.3 million in the same quarter in 2004. Operating margin increased to 9.5% in the fourth quarter of 2005 compared with 7.5% during the fourth quarter of 2004, and was considerably better than the 3.3% achieved in 2003.

Finance Expenses

Finance expenses for the fourth quarter of 2005 were almost at zero compared with US$ 0.6 million (1% of sales) in the same quarter of 2004. The decrease in finance expenses reflects the decline in the Company's debt, which dropped following loan repayment with the capital raised in February 2005 and from interest income.

Profit before Tax

Profit before tax grew 34% in the fourth quarter of 2005 to reach US$ 5.0 million (9.5% of sales) compared with US$ 3.7 million in the same quarter of 2004 (6.6% of sales).

Taxes on Income

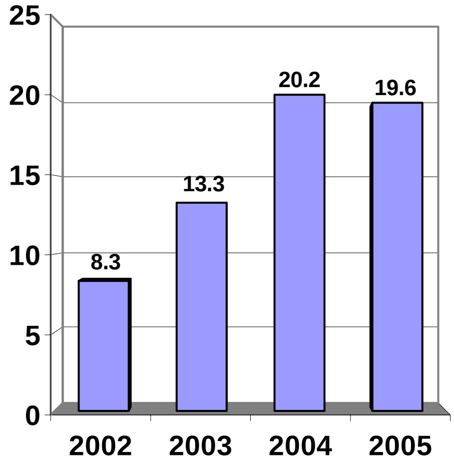
Taxes on income in the fourth quarter of 2005 totaled US$ 0.1 million (2.5% of profit before tax) compared with US$ 0.7 million in the same quarter in 2004 (18.7% of profit before tax). The savings on taxes derives mostly from the reduction of the effective tax rate in Israel and the growth in profit in regions where the tax rate is lower than the average.

Net Profit

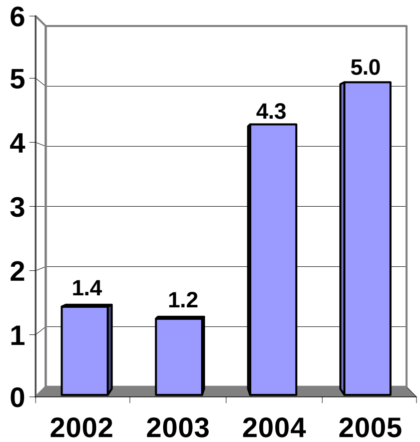
Net profit rose sharply by 60.8% during the fourth quarter of 2005 to reach US$ 4.9 million, compared with US$ 3.0 million during the fourth quarter of 2004. Net margin also rose to reach 9.3% compared with 5.3% in the fourth quarter of 2004.

Profit Development in the Fourth Quarters of 2002 – 2005 (US$ million)
(All figures for 2002 based on Israeli GAAP)

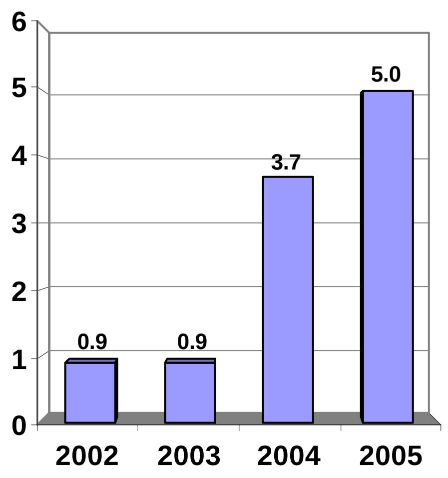
Gross Profit



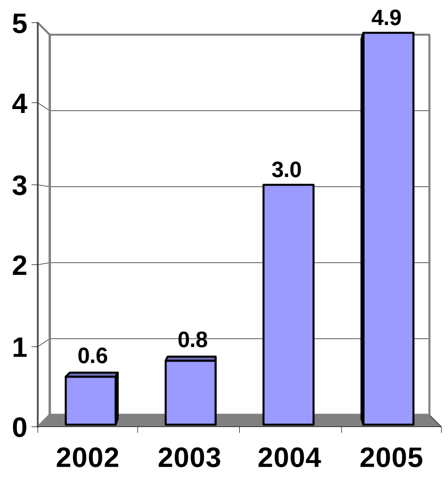
Operating Profit



Profit before Tax



Net Profit



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

	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004
Sales	52.6	59.4	67.1	64.7	56.9	51.4	44.6	43.9
Gross profit	19.6	23.0	26.9	25.0	20.2	19.5	17.9	16.7
Selling, Marketing, R&D, Administration, General and Other Expenses	14.6	15.1	15.4	15.7	15.9	12.9	11.6	11.8
Operating profit	5.0	7.9	11.6	9.3	4.3	6.5	6.3	4.9
EBITDA	7.1	10.2	13.7	11.8	6.7	8.9	8.4	7.1
Finance expenses	--	0.06	0.2	0.2	0.6	0.4	0.4	0.04
Profit before tax	5.0	7.9	11.4	9.1	3.7	6.1	5.9	4.9
Net profit	4.9	6.8	8.4	6.8	3.0	4.7	4.6	3.5

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. Sales decrease further 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, natural functional food ingredients and natural pharma/nutraceutical extracts, which generally have lower seasonality in demand.

A substantial proportion of the sales of Nesse, 70% of whose share equity Frutarom acquired in January 2006, are to the savory sector. This is also expected to reduce the influence of seasonality.

Financial Status

Total assets on December 31, 2005 amounted to US$ 233.9 million compared with US$ 213.7 million at December 31, 2004.

The Company's current assets totaled US$ 129.9 million compared with US$ 104.0 million at the end of 2004.

Fixed assets minus accumulated depreciation and net other assets totaled US$ 98.7 million on December 31, 2005, compared with US$ 102.0 million at the end of 2004.

Liquidity

During 2005, Frutarom achieved cash flow from operating activity of US$ 32.5 million compared with US$ 17.3 million in 2004. In addition to the cash flow from operating activity, the company received consideration from the sales of non operational assets (the plant in Canada and assets in Hungary acquired in 2003 as part of the Flachsmann transaction) in the amount of US$ 6 million and payments received from IFF (in accordance with the acquisition adjustment mechanism that was part of the agreement to acquire IFF's food systems activity) in the amount of US$ 4.6 million. The consideration received from the offering in London main list in February 2005 were used to repay loans, make investments and increase the cash balance.

The cash flow from current activities achieved by Frutarom during the fourth quarter of 2005 rose by 220% totaled US$ 5.6 million compared with US$ 1.8 million in the fourth quarter of 2004.

Sources of Finance

Sources of the Company's Equity

The Company's equity at December 31, 2005 totaled US$ 177.8 million (76% of the balance sheet) compared with US$ 78.7 million (36.8% of the balance sheet) on December 31, 2004. Most of the growth in the Company's equity during 2005 derives from the capital raised by the Company in February 2005 and the profit for the year. The growth in the Company's equity was offset somewhat by the dividend distributed by the Company and translation differences of the consolidated companies in the Company's financial reports in the amount of US$ 11.9 million.

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

The average scope of long term credit from banks at December 31, 2005 totaled US$ 10.1 million. During the same period last year, the Company had US$ 35.7 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, 2005 totaled US$ 4.2 million. During the same period in 2004, the Company had US$ 17.6 million at its disposal.

Credit From Suppliers and Customers (Annual Average)

The average scope of credit from suppliers and other creditors in 2005 was US$ 43.7 million (US$ 36.6 million during 2004). During 2005, the Company granted average credit of US$ 46.5 million to receivables (US$ 36.8 million during 2004).

Disclosures about Market Risk

General

The Company's activity is characterized by considerable dispersion. 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 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.

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 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 their price, quality and availability could be adversely affected by unfavorable weather conditions, among others. The Company does not normally make forward transactions and is exposed to price fluctuations in the 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 subsidiary 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 the 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 and its debt was not substantial.

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 in terms of quantity 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 raw material prices. Ongoing follow up is conducted in this area and there is no limit in terms of quantity. 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 2005 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 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 2005 there were no 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, 2005 (in US$ 000)

	USD	GBP	Euro	CHF	Other Currencies	NIS	Total
Assets							
Cash and Equivalents	19,016	1,932	8,877	3,015	697	186	33,723
Customers	11,113	4,025	8,642	3,328	3,631	9,550	40,289
Other Debtors	2,872	714	2,687	1,944	568	178	8,962
Inventory	28,690	4,873	2,460	10,863			46,886
Other, Long term	3,673	2	1,618		5		5,297
Fixed assets, net	27,234	6,336	9,476	44,859			87,905
Other assets, net	2,002	6,293	903	1,606			10,804
Total	94,599	24,176	34,662	65,615	4,900	9,914	233,866
Liabilities							
Supplier	4,853	1,419	3,705	3,163	147	4,608	17,895
Other creditors	4,996	1,899	1,958	5,497	481	7,878	22,709
Bank loans (Including current maturities)				289			289
Employee retirement rights liabilities	760		6,098	917			7,775
Deferred taxes	3,048	1,239	639	2,465			7,390
Shareholders Equity							177,808
	13,658	4,557	12,399	12,330	629	12,486	233,866
Net Assets (Liabilities)	80,942	19,619	22,263	53,284	4,272	-2,572	0

Events Following the Balance Sheet Date

In January 2006, the Company acquired 70% of Nesse's share equity for a cash consideration of Eur 18.4 million. For further information on this acquisition refer to Events Following the Balance Sheet Date.

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. The internal auditor is not an employee of the Company.

Scope of the Internal Auditor's Position

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 the basis of two and a half days per week.

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 considerations directing the program's preparation are based on subjects perceived as worthy of thorough analysis with the aim of locating faults, achieving efficiencies, and 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.

Audit Program of Subsidiaries

The annual audit program also includes the subsidiaries that are material holdings of the Company. The internal auditor conducts at least one audit per year at each significant 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 that 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 2005

During 2005, four meetings were held, at which 14 audit reports were 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.

Allotment of Shares and Distribution of Dividend

In March 2005, the Board of Directors of the Company declared the distribution of a cash dividend at the rate of 13% of the issued and paid share equity of the Company, totaling US$ 1,740,000. April 18, 2005 was set as the record date and the dividend was distributed on May 1, 2005.

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 the critical accounting estimations used in preparing the financial reports of the Company; during their consolidation, 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 based 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 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 management's estimates based on the size of the debt and data on the customer’s business status.

C. Depreciation and Amortization Policy

Most of the Company’s non financial assets are comprised of buildings, machinery and equipment as well as intangible assets such as knowhow, customer relationships and goodwill. The Company amortizes the intangible assets over the period of their 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 with similar assets.

D. Asset Value 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, makes 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 received from its 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.

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 Inc., 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 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 Caesaria Vardinon Textiles Ltd. Mr. Netanel 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 as managing director and CEO of Rogosin Enterprises Ltd. Mr. Netanel was a partner in the 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., Taldor 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 LLB and an MBA from Tel Aviv University.

Mr. Yair Seroussi – Mr. Seroussi has served as a director on the board of directors of Frutarom since June 2005. Until 1992 Mr. Seroussi served as the head of the Israeli Ministry of Finance's delegation to the United Stated and manager of the commodities delegation. Since 1993 he has represented investment banker Morgan Stanley in Israel and served as Managing Director of Admiral Holdings Ltd. and as a financial advisor. Mr. Seroussi is an external director in the Israel Company Ltd. and Aspen Building and Development Ltd., as a director in DSPG and Chairman of the Board of Eyal Microwave Ltd. Mr. Seroussi holds a degree in economics and social studies from the Hebrew University in Jerusalem and serves on its Board of Trustees.

Mr. Hans Abderhalden – Mr. Abderhalden has served as a director on the board of directors of Frutarom since December 2004. Since 2002 Mr. Abderhalden has also served a director on the board of directors of Frutarom Switzerland. Mr. Abderhalden possesses 25 years of experience in the flavor and fragrance industry. From 2000 through 2002 Mr. Abderhalden served as president and chief executive officer of Emil Flachsmann AG. Prior to that Mr. Abderhalden worked for Givaudan as president of the global flavors division and in other positions.

Peer Review

In accordance with the instructions of the Securities Authority of July 28, 2005, regarding the disclosure of agreement to perform a peer review whose goal, according to the stated instructions, is to put in place a process of control on the audit work performed by the auditor, which will contribute to the existence of an advanced equity market, the Company agreed to the transfer of the information required to perform a sampling related to the colleagues review. As stated, the Company's agreement was given subject to the receipt of the auditor's commitment according to which before beginning a review of the material relating to the Company, the Company's auditor will first certify that the accountants performing the review commit to maintaining all material transferred to them as part of the peer review procedure in confidence and to avoid any situation of conflict of interest.

Disclosure Regarding the Remuneration of the Auditor

In accordance with the instructions of the Securities Authority of January 29, 2006, the remuneration paid by the Company to its auditor is as detailed below:

A. Remuneration for audit services, for services related to the audit and for tax services for 2005 is US$ 100,000 and US$ 410,000, for Israel and for the overseas subsidiaries, respectively. The amount paid for audit and tax services does not exceed 45% of the total remuneration in this section.

B. Other remuneration – The total remuneration for services provided by the auditor that are not included in Section A above for 2005 is US$ 9,000 and US$ 44,000 for Israel and for the overseas subsidiaries, respectively.

Events Following the Balance Sheet Date

Nesse Acquisition

Following the balance sheet date, on January 17, 2006, Frutarom signed an agreement to acquire 70% of the issued and paid up share equity of Nesse. The acquisition was performed through Frutarom Germany GmbH, which is a wholly owned subsidiary of Frutarom. Nesse's sales turnover in 2004 was Euro 21.4 million.

Nesse has been active since 1880 and today is an international group achieving high internal growth that employs about 120 people. Nesse operates two production sites in Germany and has sales and marketing representatives in 20 additional countries, mainly in Eastern and Western Europe. Nesse develops, produces, markets and sells innovative, unique savory solutions that include savory flavors and specialty functional ingredients. Nesse's extensive customer base includes hundreds of food manufacturers, principally in Eastern and Western Europe.

The consideration paid by Frutarom upon signature of the agreement to acquire 70% of Nesse's issued and paid up shares was Euro 18.41 million. In addition, the sellers are entitled to a one time future payment on March 31, 2008, which will be based on continued improvement, to the extent achieved, in Nesse's operating profit in the years 2005-2007. The acquisition was financed through Frutarom's own resources. As part of the acquisition agreement, Frutarom has a call option to purchase and the sellers have a put option to sell, for a period of two years as of the end of 2007, the remaining 30% of Nesse's issued and paid up shares. The exercise price will be based on 30% of the average annual operating profit achieved by Nesse during the eight quarters preceding the exercise of the option, multiplied by 6.5.

This strategic acquisition is another significant milestone in implementing Frutarom's rapid growth strategy. The acquisition significantly strengthen Frutarom's technological capabilities and offering to customers in the savory field and contribute to strengthening and positioning Frutarom in both West and East Europe as a leading flavors supplier.

Nesse's savory activity is synergetic with Frutarom's activities in the more than 100 countries in which Frutarom operates, especially in Western and Eastern Europe. Frutarom intends to take advantage of its large, dedicated global sales and marketing infrastructure to realize the substantial cross-selling opportunities created by the acquisition, by expanding both the customer base and the product portfolio. The acquired activity also includes activities in additional countries where Frutarom has been less active, such as Poland, the Czech Republic, Latvia, and Slovenia, among others.

Private Offering

In accordance with the decision of the Audit Committee and the Board of Directors on January 2, 2006 regarding a material private offering and a non-material private offering, and after receiving the approval of the Tel Aviv Stock Exchange Ltd. to register for trade the shares that would be yielded by the exercise of options, on January 31, 2006 the Company allotted 725,000 non-transferable options to four senior officers of the Company. The options were allocated to the officers without remuneration 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 in consideration for an exercise price of NIS 31.068 per option, and in total for 725,000 ordinary shares in the Company.

Distribution of a Dividend

On March 14, 2006, 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 0.16 per share for an overall total of NIS 9,2 million.

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

The Board of Directors of the Company held six 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	Ori Yehudai
Chairman of the Board	President & CEO

March 14, 2006