FRUTAROM INDUSTRIES LTD.
DIRECTORS REPORT TO THE SHAREHOLDERS
FOR THE PERIOD ENDING JUNE 30, 2006[1]

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, beverages, flavors, fragrances, pharma/nutraceuticals and personal care products. Frutarom operates production facilities in Europe, North America, Israel and Asia, and produces, markets and sells over 15,000 products to more than 5,000 customers in over 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 growth, above industry average, through both internal growth in its core activities 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 the CIS, Eastern Europe and Asia, where growth rates are higher than the global average. Frutarom offers its customers a wide product portfolio 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 in the past six consecutive years, during the second quarter of 2006 Frutarom achieved growth in sales. Frutarom's sales for the second quarter of 2006 totaled US$ 72.3 million, growing 7.9% compared with the same quarter of 2005. Gross profit for the quarter reached US$ 26.3 million compared with US$ 26.9 million in the same quarter of 2005. Gross margin reached 36.3% compared with 40.1% for the same period of 2005. Operating profit totaled US$ 9.7 million compared with US$ 11.6 million in the same quarter of 2005. Operating margin was 13.4% compared with 17.2% for the same quarter of 2005. The decline in gross and operating profit and profitability in the second quarter is mainly due to fluctuations, which the Company believes to be temporary in nature, in the prices of raw materials used in Frutarom's production. Profit before tax reached US$ 9.1 million compared with US$ 11.4 million in the same quarter of 2005. Net profit grew and totaled to US$ 8.6 million compared with US$ 8.4 million for the second quarter last year. Net margin reached 11.8% compared with 12.5% during the same quarter in 2005.

Profit per share during the second quarter was US$ 0.15, identical to the same quarter of 2005.

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[1] Prepared in accordance with the consolidated financial reports of the Company, which were prepared in accordance with the IFRS.

Frutarom's sales for the first half of 2006 totaled US$ 143.3 million, growing 8.7% compared with the same half of 2005. Gross profit for the six month period totaled US$ 53.3 million compared with US$ 51.9 million in the same half of 2005. Gross margin reached 37.2% compared with 39.4% for the same period of 2005. Operating profit totaled US$ 20.0 million compared with US$ 20.8 million in the same half of 2005. Operating margin was 14.0% compared with 15.8% for the same period of 2005. Profit before tax totaled US$ 19.8 million compared with US$ 20.5 million in the same half of 2005 and net profit rose to reach US$ 17.4 million compared with US$ 15.2 million for the first half last year. Net margin reached 12.1% compared with 11.5% during the same half in 2005.

Profit per share during the first half was US$ 0.31 compared with US$ 0.28 during the same six month period of 2005.

Summary of the Company's Activity

Frutarom operates in the global flavors and fine ingredients markets. In the flavors market, Frutarom is active mainly 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.

Leffingwell & Associates estimates that in 2004, the global market for flavors, fragrances and fine ingredients amounted to approximately US$ 17.7 billion. Frutarom does not operate in the market for fragrance compounds, but does operate in the markets for functional food ingredients (which is not included in the above estimation). Accordingly, the Company believes that the global market in which it operates had sales of approximately US$ 15.0 billion in 2005.

SRI Consultants estimates 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, with a significantly higher growth rate expected in emerging markets in which Frutarom operates, such as Eastern Europe, Russia, China, and India, due to the expected increases in GNP and changes in consumer preferences in these markets. In addition, according to SRI Consultants, the market for functional food ingredients, on which Frutarom focuses and views as an important element of its rapid growth strategy, is expected to grow in the next several years at a higher rate than other segments, with sales expected to grow at an annual 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 more profitable of Frutarom's Divisions and has experienced accelerated growth in recent years 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, citrus products, aroma chemicals, and natural gums and stabilizers. The Division's products are sold principally to the food, beverage, flavor and fragrance, pharma/nutraceutical and personal care industries. The Fine Ingredients Division has experienced growth in recent years as a result of both internal growth and several successful 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. Most of the Division's products are natural products, which enjoy a higher demand than non-natural products. Frutarom operates to expand the natural product portfolio it offers to its customers, with particular emphasis on the functional food area.

The activities of Frutarom's two Divisions are greatly complementary and synergetic. This synergy is expressed in several main fields: (1) sales and marketing - one salesperson handling each customer; Fine Ingredients Division products 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 - the majority of Frutarom's production sites are jointly utilized by the two Divisions; (4) raw materials - although the majority of raw materials produced by the Company are sold to third parties, some specialty fine ingredients are exclusively used by 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 rapid growth strategy that it has successfully implemented in recent years. The strategy combines rapid internal growth of the more profitable core activity at higher than industry average rates, 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 of 2006

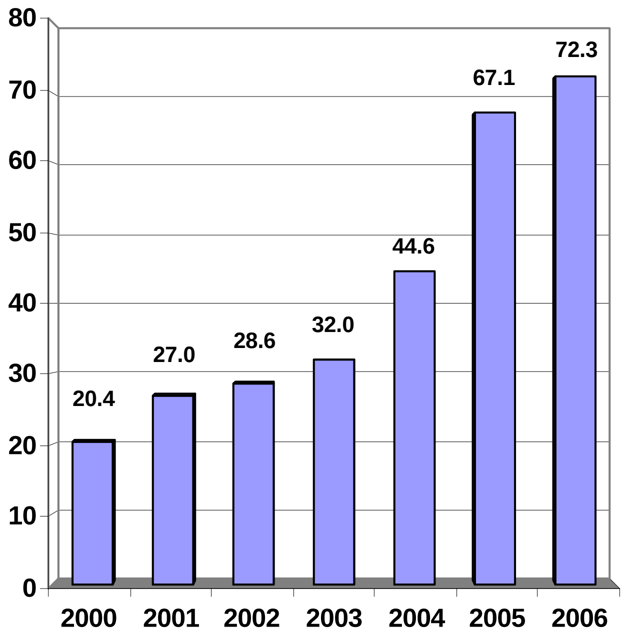
Following is a summary of the profit and loss report for the second quarter (US$ millions):

	2006	2005	Change (%)
Sales	72.3	67.1	7.9%
Gross profit	26.3	26.9	-2.4%
R&D, Selling, Administration, General and Other income	16.6	15.4	8.1%
Operating profit	9.7	11.6	-16.5%
EBITDA	12.4	13.7	-9.6%
Profit before tax	9.1	11.4	-20.2%
Net profit	8.6	8.4	2.2%

Sales

Frutarom's sales during the second quarter of 2006 totaled US$ 72.3 million, showing growth of 7.9%, compared with the same quarter of 2005. Sales grew by 7.3%, excluding the impact of the strengthening US dollar against the European currencies (in which most of Frutarom's sales are made) .

Sales Development in the Second Quarter of 2000-2006 (US$ millions)



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

A. The integration of Nesse's activity, which was acquired and consolidated with Frutarom's activity as of January 2006, with the Frutarom Group's global activity.

B. Growth in the sales of flavors produced and sold by the Company's Flavors Division.

C. Utilizing the synergy and cross selling opportunities between Frutarom's Divisions, customers and products, both existing and those added through the acquisitions made in recent years.

The increase in sales was offset by the following factors:

A. Compared with the parallel period, sharp erosion in the prices of natural products sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries (mainly vanilla, grapefruit oil and natural gums) and in the selling prices of flavor compounds produced by the Flavors Division using these same natural ingredients. The decline in the prices of these raw materials, compared with the same period in 2005, is due to their steady supply this year compared with a severe shortage as a result of especially severe weather conditions in their growing areas which led to unusual price rises last year.

B. Decrease in sales of food systems products due to the planned improvement in product mix that will be achieved by shifting from products with lower than average margin to unique products with high added value and higher margin than average.

Sales Breakdown by Fields of Activity in the Second Quarter of 2000-2006 (in % and US$ millions)

		2000	2001	2002	2003	2004	2005	2006
Flavors Division	Sales	6.6	10.9	11.9	15.7	23.7	43.1	49.8
	%	32.2%	40.4%	41.7%	49.1%	53.1%	64.2%	68.9%
Fine Ingredients Division	Sales	12.6	15.1	15.5	15.2	19.7	23.7	22.5
	%	61.8%	55.9%	54.4%	47.4%	44.2%	35.3%	31.1%
Trade & Marketing	Sales	1.6	1.4	1.6	1.7	1.9	1.5	1.5
	%	7.8%	5.2%	5.7%	5.5%	4.2%	2.2%	2.0%
Inter Division	Sales	-0.3	-0.4	-0.5	-0.6	-0.8	-1.2	-1.4
	%	-1.8%	-1.5%	-1.7%	-1.9%	-1.8%	-1.8%	-2.0%
Total Sales		**20.4**	**27.0**	**28.6**	**32.0**	**44.6**	**67.1**	**72.3**

Gross Profit

Gross profit during the second quarter of 2006 reached US$ 26.3 million compared with US$ 26.9 million in the same quarter of 2005, a decline of 2.4%. Gross margin was 36.3% during the period compared with 40.1% during the same period in 2005. The decline in profit and profitability during the quarter derives mainly from the influences, which the Company believes to be temporary in nature, of changes in the prices of raw materials used in Frutarom's production. Rising fuel and energy prices resulted in a certain increase in the prices of synthetic raw materials used by both Divisions for their production. Frutarom is diligent in seeking to raise the selling prices of its products in such a manner as to improve the Company's margin. In parallel with the rise in synthetic raw materials prices, there were significant drops in the prices of several natural raw materials (mainly vanilla, grapefruit oil and natural gums) sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries, and in the selling prices of flavor compounds produced by the Flavors Division using these natural raw materials. These price decreases also contributed to the erosion in profit and margin. The Company estimates that the stability seen recently in these natural raw materials prices will contribute to improved margin for the Company in the coming quarters.

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

Selling, marketing, research and development, administration, general and other expenses totaled US$ 16.6 million (22.9% of sales) in the second quarter of 2006, compared with US$ 15.3 million (22.9% of sales) during the same period of 2005. The increase in expenses is mainly the result of the addition of Nesse's activity, which was acquired in January 2006.

In accordance with the acquisition agreement with IFF for the acquisition of the Food Systems activity and the earn out mechanism in the agreement, the Company had income of about US$ 1.1 million during the period of this report (as stated in section 3 of the financial report). This income is expected to grow to about US$ 2.2 million for the entire year of 2006.

Operating Profit

During the second quarter of 2006, operating profit totaled US$ 9.7 million compared with US$ 11.6 million in the same quarter of 2005. Operating margin for the period reached 13.4% compared with 17.2% during the same period in 2005. Operating profit and profitability eroded mainly due to the erosion in gross profitability. As stated, the Company is acting to improve profit margins.

Finance Expenses

Finance expenses for the second quarter of 2006 totaled US$ 0.6 million (0.8% of sales), compared with US$ 0.2 million (0.3% of sales) in the same period in 2005.

Profit before Tax

Profit before tax for the second quarter of 2006 totaled US$ 9.1 million (12.6% of sales) compared with US$ 11.4 million (17.0% of sales) during the same period in 2005.

Taxes on Income

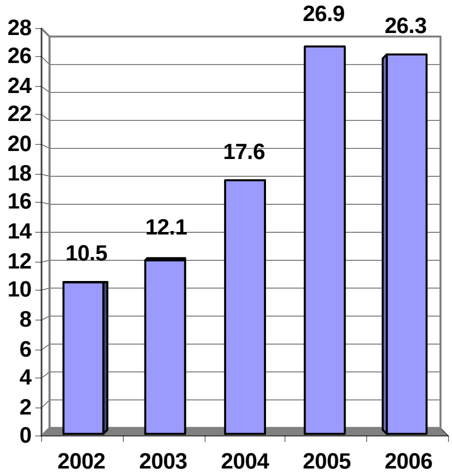
Taxes on income in the second quarter of 2006 totaled US$ 0.5 million (5.9% of profit before tax), compared with US$ 3.0 million (26.5% of profit before tax) during the same period in 2005. This decrease was mostly due to the one time reduction (about US$ 1.5 million) in the Company's taxes resulting from tax arrangements made recently in Germany following the Nesse acquisition in January 2006.

Net Profit

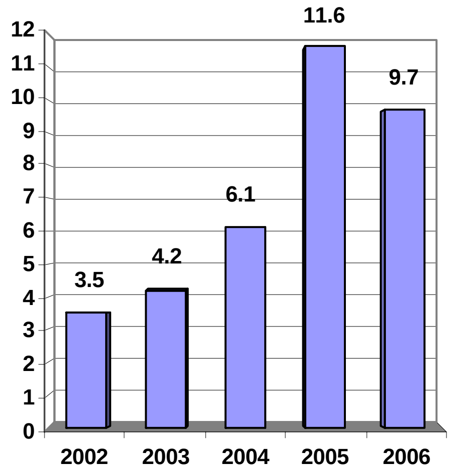
Net profit for the second quarter of 2006 totaled US$ 8.6 million compared with US$ 8.4 million in the same quarter of 2005. Net margin was 11.8% compared with 12.5% in the same quarter in 2005.

<u>Profit Development in the Second Quarter of 2002-2006 (US$ millions)</u>

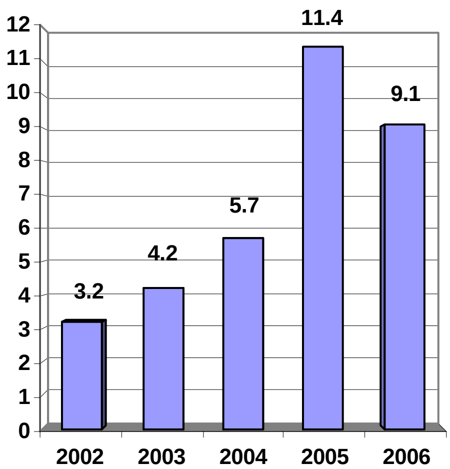
Gross Profit



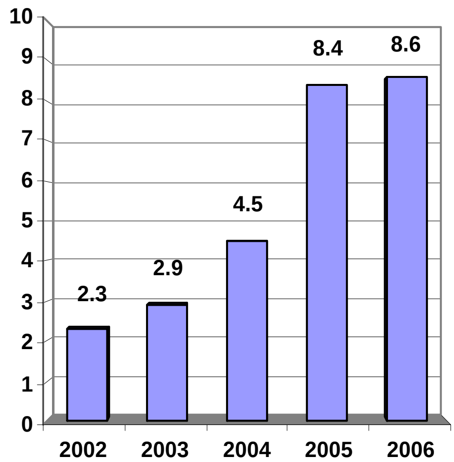
Operating Profit



Profit before Tax



Net Profit



Summary of quarterly profit and loss (US$ millions):

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Sales	72.3	71.0	52.6	59.4	67.1	64.7
Gross profit	26.3	27.0	19.6	23.0	26.9	25.0
Selling, Marketing, R&D, Administration, General and Other income	16.6	16.7	14.6	15.1	15.4	15.7
Operating profit	9.7	10.4	5.0	7.9	11.6	9.3
EBITDA	12.4	12.9	7.1	10.2	13.5	11.8
Finance expenses	0.6	-0.3	--	0.1	0.2	0.2
Profit before tax	9.1	10.7	5.0	7.9	11.4	9.1
Net Profit	**8.6**	**8.8**	**4.9**	**6.8**	**8.4**	**6.8**

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 during 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, ice cream and yogurt, 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, ice cream and yogurt restock their inventories and increase production in advance of rising demand during the summer months. This year, summer started relatively late due to the long, cold European winter.

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

A major portion of Nesse's sales (Frutarom acquired 70% of Nesse's share capital in January 2006) are intended for the savory field and thus also expected to reduce the effect of seasonality.

Results of Activity in the First Half of 2006

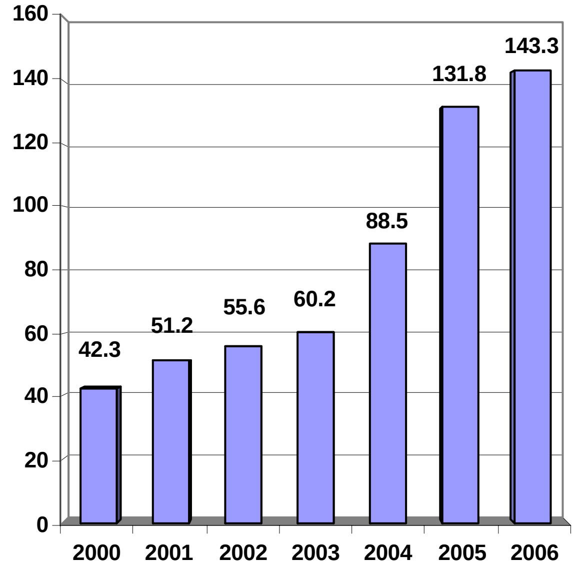
Following is a summary of the profit and loss report for the first half (US$ millions):

	2006	2005	Change (%)
Sales	143.3	131.8	8.7%
Gross profit	53.3	51.9	2.7%
R&D, Selling, Administration, General and Other income	33.3	31.1	7.0%
Operating profit	20.0	20.8	-3.9%
EBITDA	25.4	25.5	-0.3%
Profit before tax	19.8	20.5	-3.3%
Net profit	17.4	15.2	14.4%

Sales

Frutarom's sales during the first half of 2006 totaled US$ 143.3 million, showing growth of 8.7% compared with the same six month period in 2005. Sales grew by 11.1%, excluding the impact of the strengthening US dollar against the European currencies (in which most of Frutarom's sales are made).

Sales Development in the First Half of 2000-2006 (US$ millions)



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

A. The integration of Nesse's activity, which was acquired and consolidated with Frutarom's activity as of January 2006, with the Frutarom Group's global activity.

B. Growth in the sales of flavors produced and sold by the Company's Flavors Division.

C. Utilizing the synergy and cross selling opportunities between Frutarom's Divisions, customers and products, both existing and those added through the acquisitions made in recent years.

The increase in sales was offset by the following factors:

A. Compared with the parallel period, mainly in the second quarter of 2006, sharp erosion in the selling prices of natural products sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries (mainly vanilla, grapefruit oil and natural gums), and in the selling prices of flavor compounds produced using these same natural ingredients. The decline in the prices of these raw materials, compared with the same period in 2005, is due to their steady supply this year compared with a severe shortage as a result of especially severe weather conditions in their growing areas which led to the unusual price rises last year.

B. Weakening during the first quarter of European currencies, in which Frutarom conducts most sales, as compared with the US dollar, resulted in a 2.4% erosion in Frutarom's sales.

C. Decrease in sales of food systems products due to the planned improvement in product mix that will be achieved by shifting from products with lower than average margin to unique products with high added value and higher margin than average.

D. The relatively long, cold European winter postponed the demand for Frutarom products used in the production of soft drinks, ice cream, yogurt and other summer products.

E. Decrease in the trade and marketing to the domestic Israeli market of products not produced by Frutarom (not a core activity for the Company).

Sales Breakdown by Fields of Activity in the First Half of 2000-2006 (in % and US$ millions)

		2000	2001	2002	2003	2004	2005	2006
Flavors Division	Sales	13.4	20.0	22.7	28.4	42.6	83.4	94.7
	%	31.7%	39.1%	40.9%	47.2%	48.1%	63.3%	66.1%
Fine Ingredients Division	Sales	26.5	29.0	30.5	29.3	43.6	47.1	48.0
	%	62.6%	56.6%	54.8%	48.7%	49.3%	35.7%	33.3%
Trade & Marketing	Sales	3.1	2.9	3.3	3.5	3.6	3.3	2.9
	%	7.3%	5.7%	5.8%	5.8%	4.1%	2.5%	2.0%
Inter Division	Sales	-0.7	-0.7	-0.8	-1.1	-1.3	-2.0	-2.3
	%	-1.7%	-1.4%	-1.5%	-1.8%	-1.5%	-1.5%	-1.6%
Total Sales		42.3	51.2	55.6	60.2	88.5	131.8	143.3

Gross Profit

Gross profit grew 2.7% during the first half of 2006 to US$ 53.3 million compared with US$ 51.9 million in the same period of 2005. Gross margin was 37.2% during the period compared with 39.4% during the same period in 2005. The decline in profitability during the period derives mainly from the influences, which the Company believes to be temporary in nature, of price changes in raw materials used in Frutarom's production, particularly during the second quarter. Rising fuel and energy prices results in a certain increase in the prices of synthetic raw materials used by both Divisions for their production. Frutarom is diligent in seeking to raise the selling prices of its products in such a manner as to improve the Company's margin. In parallel with the rise in synthetic raw materials prices, there were significant drops in the prices of several natural raw materials (mainly vanilla, grapefruit and natural gums) sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries, and in the selling prices of flavor compounds produced by the Flavors Division using these materials. These price decreases also contributed to the erosion in margin. The Company estimates that the stability seen recently in these natural raw materials prices will contribute to improved margin for the Company during the coming quarters.

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

Selling, marketing, research and development, administration, general and other expenses totaled US$ 33.3 million (23.2% of sales) in the first half of 2006, compared with US$ 31.1 million (23.6% of sales) during the same period of 2005. The increase in expenses is mainly the result of the addition of Nesse's activity, which was acquired in January 2006.

Operating Profit

During the first half of 2006, operating profit totaled US$ 20.0 million compared with US$ 20.8 million in the same half of 2005. Operating margin for the report period reached 14.0% compared with 15.8% during the same period in 2005. Operating profit and profitability eroded mainly due to the erosion in gross profitability. As stated, the Company is acting to improve profit margins.

Finance Expenses

Finance expenses for the first half of 2006 totaled US$ 0.3 million (0.2% of sales), compared with expense of US$ 0.4 million (0.3% of sales) in the same period in 2005.

Profit before Tax

Profit before tax for the first half of 2006 totaled US$ 19.8 million (13.8% of sales) compared with US$ 20.5 million (15.5% of sales) during the same period in 2005.

Taxes on Income

Taxes on income in the first half of 2006 totaled US$ 2.4 million (12.0% of profit before tax) compared with US$ 5.3 million (25.7% of profit before tax) during the same period in 2005. This decrease was due to: (i) tax benefits to the Company for previous years (about US$ 1 million) for the approval of its plants in Israel as being characterized by high technological turnover, and (ii) a one time tax reduction (about US$ 1.5 million) for tax arrangements made recently in Germany following the Nesse acquisition in January 2006.

Net Profit

Net profit for the first half of 2006 rose 14.4% to total US$ 17.4 million compared with US$ 15.2 million in the same period of 2005. Net margin rose to 12.1% compared with 11.5% in the first half of 2005.

Financial Status

Total assets on June 30, 2006 amounted to US$ 283.4 million compared with US$ 236.8 million at June 30, 2005 and US$ 233.9 million at December 31, 2005.

The Company's current assets totaled US$ 140.2 million compared with US$ 127.8 million at June 30, 2005, and US$ 129.9 million at December 31, 2005.

Fixed assets minus accumulated depreciation and net other assets totaled US$ 138.2 million on June 30, 2006, compared with US$ 102.7 million at the end of the second quarter last year and US$ 98.7 million at December 31, 2005.

The growth in overall assets, and particularly in current assets, resulted mainly from the addition of Nesse's assets following its acquisition in January 2006.

Liquidity

The cash flow from current activities achieved by Frutarom during the second quarter of 2006 totaled US$ 6.3 million compared with US$ 8.2 million in the same quarter of 2005.

The cash flow from current activities achieved by Frutarom during the first half of 2006 totaled US$ 9.9 million compared with US$ 13.6 million in the same period of 2005.

Sources of Finance

Sources of the Company's Shareholders Equity

The Company's shareholders equity at June 30, 2006 totaled US$ 200.8 million (70.8% of the balance sheet) compared with US$ 168.3 million (71.1% of the balance sheet) at June 30, 2005. Most of the increase in shareholders equity resulted from the net profit achieved during the period. 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 increased 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 Company did not require any long term credit from banks during the second quarter of 2006. During the same period last year, the Company had US$ 9.3 million at its disposal.

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

Short term credit from banks totaled US$ 1.0 million. During the same period last year, the Company had US$ 1.3 million at its disposal.

Credit from Suppliers and to Customers (Quarterly Average)

During the second quarter of 2006 the average scope of credit from suppliers and other creditors was US$ 49.6 million (compared with US$ 47.4 million during the same quarter of 2005). During the second quarter of 2006, the Company granted average credit of US$ 52.6 million to its customers (compared with US$ 50.7 million during the same quarter of 2005). Most of the growth in suppliers' and customers' credit results primarily from the acquisition of Nesse in January 2006.

Disclosures about Market Risk

The Company's activity is not characterized by concentration of products and customers. 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 Company's Chief Financial Officer is responsible for managing market risks as relates to exchange rates and interest. The Company's management and Board of Directors are updated on significant changes in the Company's level of exposure to various market risks and hold discussions on the subject as required.

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.

Peer Review of the Auditors' Work

In accordance with the instructions of the Israeli Securities Authority of July 28, 2005, regarding the disclosure of consent 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 peer review. The Company's consent was given subject to obtaining the auditor's commitment according to which before beginning a review of the material relating to the Company, the Company's auditor will 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 interests.

Events Following the Balance Sheet Date

From mid July until August 14, 2006, Israel and the Hezbollah were in warfare in the southern part of Lebanon, including rocket attacks on the northern part of Israel. Frutarom has two sites in northern Israel, in Haifa and in Acco, which are responsible for about 20% of the Frutarom Group's production and employ 300 of the Group's 1,100 employees. During this period, the plants operated and efficiently supplied current orders placed by the Company's customers in Israel and throughout the world.

The Board of Directors expresses its sincere appreciation and thanks to the Company's employees in Israel for their special efforts in order to ensure, even in these difficult days of fighting, the continuation of ongoing, orderly production at Frutarom's plants in northern Israel, which enabled the Company to continue providing superior service to Frutarom's customers.

The Board of Directors of the Company held four meetings during the first half of the year.

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

August 21, 2006

FRUTAROM INDUSTRIES LTD.

INTERIM REPORT

(Unaudited)

30 JUNE 2006

FRUTAROM INDUSTRIES LTD.

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(Unaudited)

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TABLE OF CONTENTS

PRICEWATERHOUSECOOPERS

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August 21, 2006

The Board of Directors
Frutarom Industries Ltd.
Haifa

Re: Review of condensed unaudited interim consolidated
financial statements for the six and three-month periods ended 30 June 2006

At your request, we have reviewed the accompanying consolidated condensed balance sheet of Frutarom Industries Ltd. (hereafter - the company) and its subsidiaries as of 30 June 2006 and the related condensed consolidated statements of income, changes in shareholders' equity and cash flows for the six and three-month periods then ended.

We conducted our review in accordance with the procedures prescribed by the Institute of Certified Public Accountants in Israel. Inter alia, these procedures included: reading of the aforementioned financial statements, reading of minutes of meetings of shareholders, the Board of Directors and its committees, and making inquiries of company officers responsible for financial and accounting matters.

We were furnished with the reports of other certified public accountants on their review of the interim financial statements as of 30 June 2006 of consolidated subsidiaries, whose assets constitute approximately 3.34% of the consolidated totals, and whose revenues for the six and three-month periods ended 30 June 2006 constitute approximately 6.19% and 6.75% of total consolidated revenues for the periods, respectively.

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

During our review, including reading the reports of other auditors, as above, nothing came to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements are not prepared, in all material respects, in accordance with International Financial Reporting Standards, applicable to interim financial reporting (IAS 34).

Sincerely,

FRUTAROM INDUSTRIES LTD.

CONDENSED CONSOLIDATED INTERIM BALANCE SHEET

30 JUNE 2006

	30 June 2006	30 June 2005	31 December 2005
	U.S. dollars in thousands		
	(Unaudited)		(Audited)
Assets			
CURRENT ASSETS:			
Cash and cash equivalents	17,080	21,570	33,723
Short-term investments	3,187		
Accounts receivable:			
Trade	53,317	51,630	40,289
Other	10,601	7,694	6,756
Prepaid expenses and advances to suppliers	3,108	2,874	2,206
Inventories	52,922	44,076	46,886
Total current assets	140,215	127,844	129,860
NON-CURRENT ASSETS:			
Property, plant and equipment	99,220	90,338	87,905
Intangible assets	38,983	12,376	10,804
Deferred income tax assets	3,058	2,251	3,319
Other non-current assets	1,958	3,983	1,978
Total non-current assets	143,219	108,948	104,006
Total assets	283,434	236,792	233,866

) Chairman of the Board

Dr. John Farber

) President,
) CEO and Director

Ori Yehudai

) Executive Vice
) President and CFO

Alon Granot

Date of approval of the financial statements: August 21, 2006

	30 June		31 December
	2006	2005	2005
	U.S. dollars in thousands		
	(Unaudited)		(Audited)
Liabilities and shareholders' equity			
CURRENT LIABILITIES:			
Bank credit and loans	712	1,728	289
Accounts payable:			
Trade	21,207	22,159	17,895
Other	25,883	23,378	22,162
Provisions	929	903	547
Total current liabilities	48,731	48,168	40,893
NON-CURRENT LIABILITIES:			
Loans and credit from banks (net of current maturities)		6,767	
Retirement benefit obligations	8,704	7,956	7,775
Deferred income tax liabilities	5,989	5,610	7,390
Other liabilities	19,256		
Total non-current liabilities	33,949	20,333	15,165
Total liabilities	82,680	68,501	56,058
SHAREHOLDERS' EQUITY:			
Share capital	16,427	16,394	16,399
Additional paid-in capital	92,393	91,219	91,666
Currency translation differences	1,779	(2,815)	(5,160)
Retained earnings:			
Unappropriated	91,356	64,299	73,929
Appropriated			2,005
Cost of company shares held by subsidiary	(1,201)	(806)	(1,031)
Total shareholders' equity	200,754	168,291	177,808
Total shareholders' equity and liabilities	283,434	236,792	233,866

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

FRUTAROM INDUSTRIES LTD.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF INCOME

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	6 months ended 30 June		3 months ended 30 June		Year ended 31 December
	2006	**2005**	**2006**	**2005**	**2005**
	U.S. dollars in thousands				
	(Unaudited)		**(Unaudited)**		**(Audited)**
SALES	143,333	131,802	72,345	67,073	243,803
COST OF SALES	90,033	79,884	46,089	40,160	149,285
GROSS PROFIT	53,300	51,918	26,256	26,913	94,518
SELLING, MARKETING, RESEARCH AND DEVELOPMENT, GENERAL AND ADMINISTRATIVE EXPENSES - net:					
Selling, marketing, research and development - net	22,947	22,322	11,851	11,514	43,818
General and administrative	11,424	9,431	5,829	4,485	18,217
OTHER INCOME – net	1,107	676	1,085	651	1,255
OPERATING PROFIT	20,036	20,841	9,661	11,565	33,738
FINANCIAL EXPENSES - net	254	375	567	175	416
PROFIT BEFORE TAXES ON INCOME	19,782	20,466	9,094	11,390	33,322
TAXES ON INCOME	2,382	5,254	540	3,020	6,475
NET INCOME FOR THE PERIOD	17,400	15,212	8,554	8,370	26,847
	U.S. Dollars				
EARNINGS PER SHARE:					
BASIC	0.31	0.28	0.15	0.15	0.49
DILUTED	0.30	0.27	0.15	0.14	0.48

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

FRUTAROM INDUSTRIES LTD.

CONDENSED STATEMENTS OF INTERIM CHANGES IN SHAREHOLDERS' EQUITY

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	Share Capital	Additional paid in capital	Currency translation differences	Retained earnings Unappropriated	Retained earnings Appropriated	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands						
BALANCE AT 1 JANUARY 2006 (audited)	16,399	91,666	(5,160)	73,929	2,005	(1,031)	177,808
CHANGES DURING THE 6 MONTHS ENDED 30 JUNE 2006 (unaudited):							
Net income not recognized in the net profit - changes in currency translation			6,939				6,939
Net income				17,400			17,400
Total recognised income for 6 months ended 30 June 2006							24,339
Plans for allotment of company shares to employees of subsidiary:							
Purchase of company shares by a subsidiary						(379)	(379)
Receipts in respect of allotment of company shares to employees						83	83
Recognition of compensation related to the plan						126	126
Allotment of shares and options to senior employees:							
Allotment of share capital to senior employees	28	112					140
Recognition of compensation related to employee stock and options grants (Note 4)		615					615
Dividend paid (Note 5)				27	(2,005)		(1,978)
BALANCE AT 30 JUNE 2006 (unaudited)	16,427	92,393	1,779	91,356	-,-	(1,201)	200,754

FRUTAROM INDUSTRIES LTD.

CONDENSED STATEMENTS OF INTERIM CHANGES IN SHAREHOLDERS' EQUITY (continued)

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	Share capital	Additional paid in capital	Currency translation differences	Unappropriated retained earnings	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands					
BALANCE AT 1 APRIL 2006 (unaudited)	16,399	92,045	(4,059)	82,802	(1,042)	186,145
CHANGES DURING THE 3 MONTHS ENDED 30 JUNE 2006 (unaudited):						
Net income not recognised in the net profit - changes in currency translation			5,838			5,838
Net income				8,554		8,554
Total recognised income for 3 months ended 30 June 2006						14,392
Plans for allotment of company shares to employees of subsidiary:						
Purchase of company shares by a subsidiary					(260)	(260)
Receipts in respect of allotment of company shares to employees					18	18
Recognition of compensation related to the plan					83	83
Allotment of shares and options to senior employees:						
Allotment of share capital to senior employees	28	112				140
Recognition of compensation related to employee stock and options grants		236				236
BALANCE AT 30 JUNE 2006 (unaudited)	16,427	92,393	1,779	91,356	(1,201)	200,754

FRUTAROM INDUSTRIES LTD.

CONDENSED STATEMENTS OF INTERIM CHANGES IN SHAREHOLDERS' EQUITY (continued)

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	Share capital	Additional paid in capital	Currency translation differences	Retained earnings Unappropriated	Retained earnings Appropriated	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands						
BALANCE AT 1 JANUARY 2005 (audited)	13,961	17,642	5,039	41,332	1,740	(1,061)	78,653
Derecognition of the balance of recognized negative goodwill as at 31 December 2004, net, in accordance with the transition provisions of IFRS 3				7,731			7,731
BALANCE AT 1 JANUARY 2005, AFTER THE EFFECT OF THE TRANSITION PROVISIONS OF IFRS 3	13,961	17,642	5,039	49,063	1,740	(1,061)	86,384
CHANGES DURING THE 6 MONTHS ENDED 30 JUNE 2005 (unaudited):							
Net loss not recognized in the net profit - changes in currency translation			(7,854)				(7,854)
Net income				15,212			15,212
Total recognised income for 6 months ended 30 June 2005							7,358
Issuance of share capital	2,416	73,395					75,811
Plans for allotment of company shares to employees of subsidiary:							
Receipts in respect of allotment of company shares to employees						47	47
Recognition of compensation related to the plan						208	208
Allotment of shares and options to senior employees:							
Allotment of share capital to senior employees	17	68					85
Recognition of compensation related to employee stock and options grants		114					114
Dividend paid				24	(1,740)		(1,716)
BALANCE AT 30 JUNE 2005 (unaudited)	16,394	91,219	(2,815)	64,299	-,-	(806)	168,291

FRUTAROM INDUSTRIES LTD.

CONDENSED STATEMENTS OF INTERIM CHANGES IN SHAREHOLDERS' EQUITY (continued)

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	Share capital	Additional paid in capital	Currency translation differences	Retained earnings: Unappropriated	Retained earnings: Appropriated	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands						
BALANCE AT 1 APRIL 2005 (unaudited)	16,380	91,195	3,142	55,905	1,740	(931)	167,431
CHANGES DURING THE 3 MONTHS ENDED 30 JUNE 2005 (unaudited):							
Net loss not recognised in the net profit - changes in currency translation			(5,957)				(5,957)
Net income				8,370			8,370
Total recognised income for 3 months ended 30 June 2005							2,413
Plans for allotment of company shares to employees of subsidiary:							
Receipts in respect of allotment of company shares to employees						35	35
Recognition of compensation related to the plan						90	90
Allotment of shares and options to senior employees:							
Allotment of share capital to senior employees	14	55					69
Recognition of compensation related to employee stock and options grants		(31)					(31)
Dividend paid				24	(1,740)		(1,716)
BALANCE AT 30 JUNE 2005 (unaudited)	16,394	91,219	(2,815)	64,299	-,-	(806)	168,291

FRUTAROM INDUSTRIES LTD.

CONDENSED STATEMENTS OF INTERIM CHANGES IN SHAREHOLDERS' EQUITY (continued)

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	Share capital	Additional paid in capital	Currency translation differences	Retained earnings Unappropriated	Retained earnings Appropriated	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands						
BALANCE AT 1 JANUARY 2005	13,961	17,642	5,039	41,332	1,740	(1,061)	78,653
Derecognition of the balance of recognised negative goodwill as at 31 December 2004, net, in accordance with the transition provisions of IFRS 3				7,731			7,731
BALANCE AT 1 JANUARY 2005 – after the effect of the transition provisions of IFRS 3	13,961	17,642	5,039	49,063	1,740	(1,061)	86,384
CHANGES IN 2005:							
Net income not recognised in the net profit - changes in currency translation			(10,199)				(10,199)
Net income				26,847			26,847
Total recognised income for 2005							16,648
Issuance of share capital	2,416	73,451					75,867
Plan for allotment of company shares to employees of subsidiary:							
Purchase of company shares by subsidiary						(383)	(383)
Receipts in respect of allotment of company shares to employees						92	92
Recognition of compensation related to the plan						321	321
Allotment of shares and options to senior employees:							
Allotment of share capital to senior employees	22	89					111
Recognition of compensation related to employee stock and option grants		484					484
Dividend				24	(1,740)		(1,716)
Appropriation for distribution of dividend declared subsequent to balance sheet date				(2,005)	2,005		-,-
BALANCE AT 31 DECEMBER 2005	16,399	91,666	(5,160)	73,929	2,005	(1,031)	177,808

FRUTAROM INDUSTRIES LTD.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

FOR THE SIX AND THREE-MONTH PERIODS ENDED 30 JUNE 2006

	6 months ended 30 June		3 months ended 30 June		Year ended 31 December
	2006	**2005**	**2006**	**2005**	**2005**
	U.S. dollars in thousands				
	(Unaudited)		**(Unaudited)**		**(Audited)**
CASH FLOWS FROM OPERATING ACTIVITIES:					
Cash generated from operations (Note 9)	11,300	14,601	7,047	8,375	34,431
Interest paid	258	(171)	85	207	222
Income tax paid	(1,611)	(808)	(799)	(431)	(2,203)
Net cash provided by operating activities	9,947	13,622	6,333	8,151	32,450
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchase of property, plant and equipment	(5,615)	(5,258)	(3,195)	(2,883)	(12,001)
Purchase of other assets					(332)
Collection of long-term receivable					2,439
Capitalized leased fees					(382)
Acquisition of subsidiary – net of cash acquired (Note 2)	(20,261)				
Reimbursement in respect of acquisition of operations					4,598
Proceeds from sale of property, plant and equipment	258	96	42	61	4,095
Acquisition of short-term marketable securities – net	(35)		(2)		
Net cash used in investing activities	(25,653)	(5,162)	(3,155)	(2,822)	(1,583)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Issuance of share capital, net of issuance costs		75,811			75,867
Receipts from senior employees in respect of allotment of shares	140	85	140	69	111
Repayment of long-term bank loans and credit	(299)	(26,384)	(5)	(11,435)	(33,585)
Repayment of long-term credit in connection with the acquisition of Flachsmann					(1,170)
Repayment of long-term credit in connection with the acquisition of IFF		(39,468)			(39,468)
Purchase of company shares by subsidiary – net	(296)	47	(242)	35	(291)
Dividend paid	(1,978)	(1,716)	(1,978)	(1,716)	(1,716)
Net cash provided by (used in) financing activities	(2,433)	8,375	(2,085)	(13,047)	(252)
NET EFFECT OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	784	(332)	561	(199)	(1,011)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(17,355)	16,503	1,654	(7,917)	29,604
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	33,723	4,119	14,714	28,539	4,119
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF PERIOD (Note 8)	16,368	20,622	16,368	20,622	33,723

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

1. General:

a) The interim financial statements as of 30 June 2006 and for the six and three-month periods then ended (hereafter – the interim statements) were prepared in condensed form in accordance with IAS 34 -“Interim Financial Reporting.”

b) Except as mentioned in c) below, the accounting policies applied in preparation of the interim financial statements are consistent with those used in the 2005 annual financial statements; nevertheless, the interim statements do not include all the information and explanations required for annual financial statements, and should be read in conjunction with the 2005 annual financial statements.
Costs that incur unevenly during the financial year are anticipated or deferred in the interim report only if it would also be appropriate to anticipate or defer such costs at the end of the financial year.

Income tax expense is recognised based on the best estimate of the weighted average annual income tax rate expected for the entire year; changes in the said estimate, as well as changes in the amount of the tax saving to be utilized in the following years, are included as an expense for the current quarter.

c) Basis of preparation

In 2006, the Group adopted the standards mentioned below, which are relevant to its operations:

IAS 19 Actuarial gains and losses, group plans and disclosures.
IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions.
IAS 39 (Amendment), The Fair Value Option.
IAS 39 and IFRS4 (Amendment) Financial Guarantee Contracts.
IAS 21 (Amendment) Net investment in a foreign operation.
IFRS 6, Exploration for and evaluation of mineral resources.
IFRIC 4, Determining whether an Arrangement contains a Lease.
IFRIC 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds.
IFRIC 6, Liabilities arising from participation in a specific market – waste electrical and electronic equipment.

The adoption of the abovementioned standards did not result in substantial changes to the Group’s accounting policies.

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2006 and have not been early adopted:

IFRIC 7, Applying the Restatement Approach under IAS 29, effective for annual periods beginning on or after 1 March 2006.
IFRIC 8, Scope of IFRS 2, effective for annual periods beginning on or after 1 May 2006.
IFRIC 9, Reassessment of Embedded Derivatives, effective for annual periods beginning on or after 1 June 2006.
IFRS 7, Financial instruments: Disclosures, effective for annual periods beginning on or after 1 January 2007.

Management does not expect the standards to be relevant for the group.

d) The company's activity is subject to seasonal fluctuations, with generally higher sales in the first half of a given year and lower sales in the second half of a given year (in particular in the fourth quarter).
Many 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 during the summer months. As a result, sales of certain flavors and fine ingredients produced by the company are higher in the first half of the year than in the second half.

2. Acquisition of Nesse

On 17 January, 2006, the company acquired, through a subsidiary, 70% of the shares that confer ownership and control in GewürzMühle Nesse GmbH and in GewürzMühle Nesse Gebr. Kranse GmbH (hereafter – Nesse).

Nesse is an international group engaged in the development, production, marketing and sale of savory solutions, which include non-sweet flavors and specialty functional ingredients.
In consideration for the acquisition, the company paid, at date of acquisition, a total in cash of € 18.41 million (app. $ 22.3 million).

In addition, the sellers are entitled to receive, on March 31, 2008, a one-time payment, the amount of which would be based on the increase, if any, in the average operating profits of Nesse during the years 2005 – 2007, compared with the average operating profits of Nesse during the years 2003 – 2004 (hereafter – the success fee payment).

The company has an option to acquire (call option) the remaining 30% of Nesse's share capital and Nesse has the option to sell (put option) this percentage of share capital to the company; the option is exercisable for two years commencing the end of 2007. The exercise price of the option would be equal to 30% of the average annual operating profit achieved by Nesse during the eight quarters preceding the quarter in which the option would be exercised, multiplied by 6.5.

Based on the unique terms of the options, as above, the company fully consolidated (100%) the assets and liabilities of Nesse as of that date, while including the whole liability resulting from the future exercise of the call option.

The total cost of purchase, included in these financial statements, in the amount of € 33,969 thousands ($ 41,051 thousands), comprises of the present value of the liabilities, based on company's estimation, in respect of the success fee payment and in respect of the exercise of the call option, as described above, in the amount of € 3,274 thousands ($ 3,956 thousands) and € 11,657 thousands ($ 14,087 thousands), respectively; and of purchase expenses in the total amount of € 628 thousands ($ 759 thousands).

The final cost of purchase depends upon setting the final price, after taking into account the average operating profit of Nesse during the years 2005 - 2007. The cost of purchase was allocated to acquired tangible and intangible assets and to the acquired liabilities, based on their fair value at date of acquisition.
The intangible assets recognized include: product formulas in the amount of € 3,260 thousands ($ 3,939 thousands), customer relations in the amount of € 1,370 thousands ($ 1,656 thousands) and goodwill in the amount of € 17,506 thousands ($ 21,155 thousands). Product formulas and customer relations are amortised on a straight-line basis over 20 years and 10 years, respectively. Goodwill is not amortised but subject to annual impairment test.

As a result of the acquisition, in the first quarter of 2006, the financial statements of Nesse were consolidated for the first time, commencing 17 January, 2006, with those of the company; the consolidated statement of income includes the result of operations of Nesse, commencing 1 January 2006, in accordance with the purchase agreement.

Set forth below are Nesse's data included in the consolidated financial statements as of 30 June 2006:

	30 June 2006
	U.S. dollars in thousands
	Unaudited
Balance sheet:	
Current assets:	
Cash and cash equivalents	4,168
Short-term investments*	3,161
Accounts receivable:	
Trade	4,178
Other	1,565
Inventories	3,393
Deferred income tax assets	534
Fixed assets – net	5,722
Intangible assets	27,949
Current liabilities:	
Bank credit and loans	(704)
Accounts payable:	
Trade	(1,801)
Other	(2,969)
Non-current liabilities:	
Retirement benefit obligations	(254)
Deferred income tax liabilities	(226)
Other liabilities**	(19,256)
	25,460

* Includes marketable securities, which the company classifies at fair value through profit or loss.
** Includes the liability to purchase the remaining 30% under the put and call options at the amount of € 11.8 million ($ 15 million) and the liability for the success fee payment at the amount of € 3.3 million ($ 4.2 million). The liabilities are presented at present value; annual capitalization rate – 2.86%.

The acquired operations contributed revenues of $ 16,147 thousands, and net income of $ 1,919 thousands to the company for the period from 1 January 2006 to 30 June 2006.

Assets and liabilities of Nesse, at the date of acquisition:

	Fair value	Acquiree's carrying amount
	U.S. dollars in thousands	
Cash and cash equivalents	2,729	2,729
Short-term investments	2,997	2,997
Receivables:		
Trade	4,230	4,787
Other	2,245	2,245
Inventories	2,520	2,835
Property, plant and equipment – net	5,706	4,987
Goodwill*	21,155	
Intangible assets	5,595	
Deferred tax assets	349	
Bank credit and loans	(742)	(742)
Accounts payable:		
Trade	(1,949)	(1,949)
Other	(3,414)	(3,414)
Retirement benefit obligations – pensions	(156)	21
Deferred tax liabilities	(215)	
	41,050	14,496

* Goodwill arising from the purchase of Nesse is attributed to the products and to the geographical spread of the purchased business, which are complementary to those of the company; the activity of the purchased business and the activity of the company overlap only to a small extent so that the company will utilise the synergy by using the skillful workforce of Nesse and Nesse's market spread for cross selling.

The amount of $ 20,261 thousands, presented in the cash flow statements, does not include the amount of liabilities in respect of the success fee payment and in respect of the future exercise of the call option, as above, and does not include accrued purchase expenses.

3. Acquisition of European Food Systems Business from International Flavors & Fragrances Inc. in Europe in 2004:

On 17 May 2004 and 29 October 2004, the company purchased the Food Systems Business ("FS") of International Flavors and Fragrances IFF Inc. ("IFF") in Switzerland, Germany and France.

The results of the purchase of the German and Swiss operations and the France operations for the periods starting 17 August and 2 November 2004, respectively, were included in the consolidated income statement for the year ended 31 December 2004.

As of 31 December 2004, the net cost of acquisition of the German and Swiss operations and of the French operations amounted to $ 31.8 million and $ 3.2 million, respectively; this cost included purchase expenses and was net of adjustments related to the purchase – $ 2.6 million and $ 0.6 million, respectively – based on company's management estimation.

On 5 September 2005, the company and IFF signed an agreement pursuant to which, the cost of acquisition of the German and Swiss operations was reduced by approximately $ 3.5 million and the cost of the acquisition of the French operations was reduced by approximately $ 1.4 million.

As a result of the abovementioned adjustment, the company reduced the goodwill arising from the purchase of the German and Swiss operations by approximately $ 0.9 million and increased the negative goodwill, which arose from the purchase of the French operations by approximately $ 0.6 million. The increase in negative goodwill has been directly carried to income.

According to the said agreement, the company received from IFF, during September 2005, an amount of $ 2.5 million in cash. The remaining balance was set off against the company's debt to IFF, in accordance with the agreement.

The purchase agreement includes consideration adjustment mechanisms; those mechanisms include, inter alia, an earn-out mechanism, whereunder, the purchase price may decrease or increase by an additional amount of up to € 3.5 million ($ 4.3 million), depending on the results of the purchased operations in the years 2005 and 2006.

As of 31 December 2005, in accordance with the earn-out mechanism, the purchase price of the Swiss and German operations was reduced by approximately $ 2.1 million.
As a result of the abovementioned adjustment, the company reduced the goodwill arising from the purchase of the operations by approximately $ 1.3 million and a negative goodwill in the amount of approximately $ 0.8 million was created for the company. The amount of negative goodwill was carried directly to income.

As of 30 June 2006, in accordance with the earn-out mechanism mentioned above, the purchase price of the Swiss and German operations was to be reduced again by approximately $ 1.1 million. However, due to the fact that in 2005 the company wrote-off all the goodwill arising from the purchase of the operations, the amount was carried directly to income (presented among other income for the period).

4. Allotment of Options to Senior Employees

On 2 January 2006, the company's Board of Directors approved, as part of the 2003 Plan, the allotment of 725,000 non-marketable options ("Options") to four senior employees of the company; each option is exercisable into one ordinary share of NIS 1 par value.

The said options are to be held by a trustee and they will be granted to the employees in equal batches at the end of the vesting period. The vesting periods are as follows: for three senior employees – 3 equal batches – two years, three years and four years from date of grant. For 1 senior employee – 4 equal batches – one year, two years, three years and four years from date of grant.

In any case, the employees' right to exercise the options expires six years after the date of grant. The exercise price was set to NIS 31.07. The market value of the company's shares at date of allotment was NIS 34.52.

On 31 January 2005, the Tel-Aviv Stock Exchange approved the registration of 600,000 company shares of NIS 1 par value, which will arise from exercise of the said options.

The fair value of the allotted shares – computed using the Black & Scholes shares valuation model, amounted at date of grant to U.S. $ 1,620 thousands. This value is based on the following assumptions: expected dividend at a rate set to 0% in all years (as the employees are also entitled to dividend); standard deviation of expected share price returns of 29%-31%%, annual risk-free interest at a rate of 4.45%-4.35% and an expected average option life until exercise of one year, two years, three years and four years.

5. Dividend

On 14 March 2006, the company's Board of Directors resolved to distribute a dividend of NIS 0.16 per share. The total amount of dividend - $ 2,005 thousands - was distributed to the shareholders on 24 April 2006.

6. Taxes on Income:

a) During the reported period, a consolidated company operating in Germany, which holds 70% of the shares of Nesse, and other shareholders of Nesse signed a "consolidated tax filing" agreement, wereunder commencing January 1, 2007 the subsidiary and Nesse shall be assessed for tax purposes in Germany on a consolidated basis; this would enable the consolidated company to offset its carryforward tax losses as against profits generated by Nesse, should such profits be generated. In light of the said agreement, the consolidated company changed its assessments as to its ability to utilize its carryforward tax losses and included in its accounts, for the first time, a tax asset in respect of its carryforward tax losses. As a result of the above, the group's tax expenses for the reported period decreased by $ 1.5 million.

b) Further to the disclosure included in the company's 2005 financial statements regarding the Investment Center's recognition of two of the company's approved enterprise as R&D intensive and labor-intensive companies, the Investment Center granted such status to another approved enterprise of the company; approved enterprises that have been granted the said status are entitled to tax benefits based on the Investment Center's base turnover procedure (an erosion of the base turnover at a rate of 10% commencing in the first year of operation). The company has accordingly recorded in its books a tax benefit in respect of previous years in the total amount of $ 1 million.

c) In August 2005, Amendment No. 147 to the Income Tax Ordinance was published, which made a further revision to the corporate tax rates prescribed by Amendment No. 140, enacted in July 2005. As a result of the aforementioned amendments, the corporate tax rates for 2005 and thereafter are as follows: 2005 – 34%, 2006 – 31%, 2007 – 29%, 2008 – 27%, 2009 – 26% and for 2010 and thereafter – 25%

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)

AT 30 JUNE 2006

(UNAUDITED)

7. Business Segment Data:

	Flavors Division	Fine ingredients division	Trade and Marketing division	Eliminations	Consolidated
	U.S. dollars in thousands				
6 months ended 30 June 2006 (unaudited):					
Revenues	94,666	48,046	2,858	(2,237)	143,333
Segment results	15,589	4,489	115		20,193
Unallocated income					(157)
Result from operations					20,036
6 months ended 30 June 2005 (unaudited):					
Revenues	*83,376	*47,132	3,336	(2,042)	131,802
Segment results	*15,166	*5,561	219		20,946
Unallocated expenses					(105)
Result from operations					20,841
3 months ended 30 June 2006 (unaudited):					
Revenues	49,764	22,541	1,478	(1,438)	72,345
Segment results	8,227	1,443	47		9,717
Unallocated income					(56)
Result from operations					9,661
3 months ended 30 June 2005 (unaudited):					
Revenues	*43,058	*23,719	1,496	(1,200)	67,073
Segment results	*8,621	*3,047	21		11,689
Unallocated expenses					(124)
Results from operations					11,565
Year ended 31 December 2005 (audited):					
Revenues	*151,427	*89,768	6,326	(3,718)	243,803
Segment results	*24,269	*9,460	238		33,967
Unallocated expenses					(229)
Results from operations					33,738

* Reclassified.

8. Cash and cash equivalents

Cash and bank overdrafts at the end of the reported periods; include the following for the purposes of the cash flow statement:

	6 and 3 months ended 30 June		Year ended 31 December
	2006	**2005**	**2005**
	U.S. dollars in thousands		
Cash and cash equivalents	17,080	21,570	33,723
Bank overdrafts	(712)	(948)	
	16,368	20,622	33,723

9. Cash Flows from Operations:

	6 months ended 30 June		3 months ended 30 June		Year ended 31 December
	2006	**2005**	**2006**	**2005**	**2005**
	U.S. dollars in thousands				
	(Unaudited)		**(Unaudited)**		**(Audited)**
Net income	17,400	15,212	8,554	8,370	26,847
Adjustments required to reflect the cash flows from operating activities:					
Depreciation and amortisation	4,670	4,358	2,391	2,067	8,330
Recognition of compensation related to the plan and to employee stock and option grants	741	322	319	59	805
Liability for employee rights upon retirement – net	246	341	74	156	293
Deferred income taxes - net	(1,150)	489	(1,324)	496	1,298
Loss from sale of fixed assets	30	42	7	40	328
Other	272	85	139	(2)	83
Provisions	382	(226)	142	(219)	(596)
Negative goodwill arising from the acquisition of of IFF (Note 3)	(1,089)	(593)	(1,089)	(593)	(1,496)
	4,102	4,818	659	2,004	9,045
Changes in working capital:					
Decrease (increase) in accounts receivable:					
Trade	(7,628)	(10,342)	1,650	(3,021)	944
Other	(875)	(2,371)	(337)	(1,000)	(1,375)
Decrease in accounts payable:					
Trade	656	5,136	(1,953)	3,018	(998)
Other	(242)	4,548	220	391	5,530
Increase in inventories	(2,113)	(2,400)	(1,746)	(1,387)	(5,562)
	(10,202)	(5,429)	(2,166)	(1,999)	(1,461)
Cash flows from operating activities	11,300	14,601	7,047	8,375	34,431