FRUTAROM INDUSTRIES LTD.
DIRECTORS REPORT TO THE SHAREHOLDERS
FOR THE PERIOD ENDING DECEMBER 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 and beverages, flavors and 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 120 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 the industry average, through both internal growth in its core activities and strategic acquisitions. In accordance with this strategy, at the beginning of 2006 Frutarom acquired 70% of the share equity of the Nesse group, which develops, produces, markets and sells innovative, unique solutions that include savory flavors and unique functional raw materials. This acquisition strengthens Frutarom's technological capabilities and product portfolio for customers in the savory field, and supports Frutarom's continued growth and positioning in Western and Eastern Europe as a leading flavors supplier. In addition, at the beginning of October this year, Frutarom acquired 100% of the share equity of the Acatris Health Group, which operates from Holland, Belgium and the United States. Acatris Health develops, produces and markets unique and innovative botanical ingredients possessing scientifically proven health properties. The acquisition of Acatris Health contributes to strengthening Frutarom's position as a leading global supplier of natural, unique ingredients and extracts with added value with proven health attributes and bolsters the realization of Frutarom vision, "*To be the Preferred Partner for Tasty and Healthy Success*." Frutarom persists in investing considerable efforts and resources to implement its strategy for rapid growth in order to strengthen its position as one of the leading global companies in the field of flavors and unique fine ingredients.

Frutarom focuses on large multinational customers and on 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, East Europe, Asia, and South and Central America, 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

[1] Prepared in accordance with the consolidated financial reports of the Company for December 31, 2006, which were prepared in accordance with IFRS.

research and development activities. As part of these research and development activities and to expand its offering of natural, innovative and unique products, Frutarom is creating cooperation with universities, research institutes and start-ups in Israel and elsewhere in the world. In the last year, Frutarom initiated several such collaborations that strengthen and broaden the pipeline of new and innovative products that Frutarom intends to launch in the coming years.

As in the past six consecutive years, during 2006 the trend of growth in sales and profits continued. Frutarom's sales for the year 2006 totaled US$ 287.2 million, growing 17.8% compared with 2005, when sales totaled US$ 243.8 million. Gross profit for 2006 rose 12.0% to total US$ 105.9 million compared with US$ 94.5 million in 2005. Gross margin reached 36.9% compared with 38.8% in 2005. Operating profit rose 9.8% to reach US$ 37.1 million compared with US$ 33.7 million in 2005. Operating margin was 12.9%, compared with 13.8% in 2005. Profit before tax rose 9.9% to total US$ 36.6 million compared with US$ 33.3 million in 2005. Profitability before tax reached 12.7% in 2006 compared with 13.7% in 2005. Taxes on income in 2006 totaled US$ 6.9 million (18.9% of profit before tax) compared with US$ 6.5 million (19.4% of profit before tax) in 2005. Net profit grew 10.6% to total US$ 29.7 million compared with US$ 26.8 million in 2005 and net margin reached 10.3% compared with 11.0% in 2005.

Profit per share for 2006 was US$ 0.52 compared with US$ 0.49 per share in 2005.

Frutarom's sales for the fourth quarter of 2006 totaled US$ 72.6 million, growing 38.1% compared with the same quarter of 2005. Gross profit for the quarter rose 31.1% to total US$ 25.7 million compared with US$ 19.6 million in the same quarter in 2005. Gross margin reached 35.3% compared with 37.2% for the same period of 2005. Operating profit for the fourth quarter rose 56.0% to total US$ 7.8 million, compared with US$ 5.0 million in the same period in 2005. Operating margin was 10.6% compared with 9.5% for the same quarter of 2005. Profit before tax rose 53.3% to total US$ 7.7 million compared with US$ 5.0 million in the same quarter of 2005. Profitability before tax for the fourth quarter reached 10.6% compared 9.5% in the same period of 2005. Taxes on income for the fourth quarter of 2006 totaled US$ 2.3 million (30.6% of profit before tax) compared with US$ 0.1 million (2.5% of profit before tax) in the same period last year, when the Company recorded a one time tax benefit that contributed to reducing taxes on income. Net profit rose 9.1% to US$ 5.3 million compared with US$ 4.9 million for the same quarter last year. Net margin reached 7.3% compared with 9.3% in the same quarter in 2005, when the Company recorded the above mentioned one time tax benefit.

Profit per share for the fourth quarter of 2006 was US$ 0.09, similar to the same period last year.

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 the global market for flavors, fragrances and fine ingredients at approximately US$ 18 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 has sales of approximately US$ 15 billion.

According to an estimate published in 2004 by SRI Consultants and IAL Consultants, 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. The growth rate in emerging markets in which Frutarom operates, such as East Europe, Russia, China, India, and South America is expected to be considerably higher due to the expected increases in GNP and changes in consumer preferences in these markets. According to SRI Consultants, the market for functional food ingredients in Europe and the United States is expected to grow at a higher annual rate of 9% in the next several years. Frutarom regards its activity in the functional food ingredients market as an important element in its rapid growth strategy.

Frutarom'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 (the more profitable of Frutarom's Divisions) 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, 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, unique 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 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 acts to expand the natural product portfolio it offers to its customers, with particular emphasis on the functional food area.

Frutarom will continue to invest considerable efforts and resources in successfully implementing its rapid growth strategy of recent years 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 2006

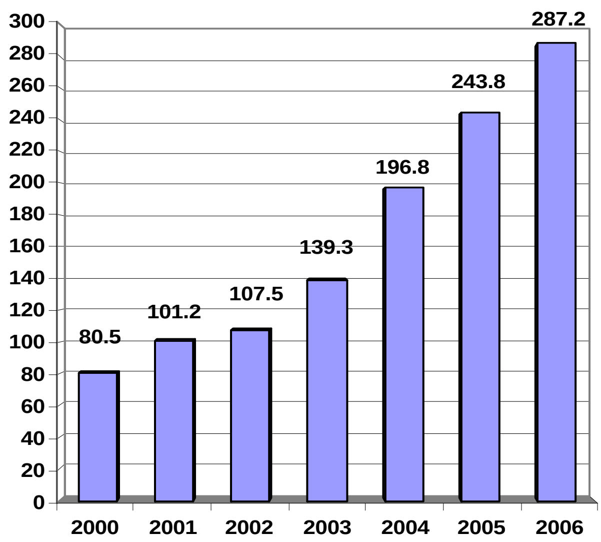
Following is a summary of the profit and loss report for 2006 (US$ millions):

	2005	2006	Change (%)
Sales	243.8	287.2	17.8%
Gross profit	94.5	105.9	12.0%
R&D, Selling, Administration, General and Other income	60.8	68.8	13.2%
Operating profit	33.7	37.1	9.8%
EBITDA	42.9	48.6	13.4%
Profit before tax	33.3	36.6	9.9%
Net profit	26.8	29.7	10.6%

Sales

Frutarom's sales during 2006 totaled US$ 287.2 million, showing growth of 17.8% compared with 2005.

Sales Development in 2000-2006 (US$ millions)



The following were the main factors contributing to the increase in sales:

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

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

C. Growth in the sales of the Fine Ingredients Division, deriving mainly from the introduction of new products.

D. The integration of Acatris's activity, which was acquired and consolidated as of October 2006 with the Frutarom Group's global activity.

E. 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. 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 than average margin.

B. Decline in the prices of natural products sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries (mainly grapefruit, vanilla 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 in 2006 compared with a severe shortage (as a result of especially severe weather conditions in their growing areas) that led to unusual price rises in 2005.

Breakdown of Sales by Geographic Region

Most of the Company's sales are in Europe, North America, Israel, Asia and the Far East. In 2006, 60.8% of the Company's sales were in Europe, 12.0% in North America, 11.5% in Israel, and 8.8% in Asia and the Far East.

The following table sets forth the Company's sales in 2004, 2005 and 2006, broken down by geographic regions (US$ millions):

	2004	2005	2006	Change (%) 2006 vs 2005
Europe	102.2	143.3	174.6	21.8%
North America	30.3	30.3	34.4	13.5%
Israel	27.3	31.0	33.1	6.8%
Asia and Far East	24.4	24.8	25.4	2.4%
Other	12.6	14.4	19.7	36.8%
Total	196.8	243.8	287.2	17.8%

The significant growth in the Company's sales in Europe in recent years is mainly the result of strategic acquisitions made by Frutarom (the acquisition of flavors and fine ingredients activity from CPL Aromas Ltd. in 2001, of Flachsmann in 2003, of IFF's Food Systems activity in 2004, and of Nesse and Acatris in 2006) combined with internal growth in core activities. As part of its strategy, Frutarom intends to grow the relative portion of its sales in North America and Asia through a combination of internal growth and strategic acquisitions.

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.

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

		2000	2001	2002	2003	2004	2005	2006
Flavors Division	Sales	26.5	39.1	45.3	68.2	110.9	150.4	187.0
	%	32.9%	38.7%	42.2%	49.0%	56.3%	61.7%	65.1%
Fine Ingredients Division	Sales	49.0	57.5	57.7	67.0	81.7	89.8	98.4
	%	60.9%	56.9%	53.7%	48.0%	41.5%	36.8%	34.2%
Trade & Marketing	Sales	6.3	5.6	6.2	6.5	6.8	6.3	6.7
	%	7.8%	5.6%	5.7%	4.7%	3.5%	2.6%	2.3%
Inter Division	Sales	-1.3	-1.2	-1.7	-2.3	-2.6	-2.7	-4.9
	%	-1.6%	-1.2%	-1.6%	-1.7%	-1.3%	-1.1%	-1.6%
Total Sales		80.5	101.0	107.5	139.3	196.8	243.8	287.2

In recent years, the relative portion of the Flavors Division (whose products have higher margin than the Fine Ingredients Division's products) has grown to reach 65.1% of Frutarom's total sales in 2006 compared with 32.9% in 2000. This growth derives from the acquisition of Nesse at the beginning of 2006 and organic growth in sales of the Division's products. As a result of the accelerated growth in the Flavors Division's relative portion, the relative portion of the Fine Ingredients Division has decreased to 34.2% compared with 60.9% in 2000 despite the fact that its sales have doubled in monetary terms between the years 2000 and 2006. The Company's Trade & Marketing activity in Israel, which constitutes 2.3% of the Company's sales, is not considered by the Company's management to be a core activity.

Gross Profit

Gross profit during 2006 grew 12.0% to reach US$ 105.9 million compared with US$ 94.5 million in 2005. Gross margin was 36.9% compared with 38.8% during the same period in 2005. The decline in gross margin during the year derives mainly from price increases in raw materials used to produce Frutarom's products. The rise in fuel and energy prices resulted in a certain increase in the prices of synthetic raw materials used to manufacture the products of both Divisions. In parallel to the increase in synthetic raw materials prices, prices of several natural raw materials sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries (mainly grapefruit, vanilla and natural gums) decreased significantly, as did the selling prices of flavors produced by the Flavors Division using the same natural raw materials. The acquisition of Nesse and Acatris contributed to the growth in gross profit, but due to their having a lower gross margin than the average for Frutarom, they caused a decrease in gross profit margins. Frutarom continues to work to improve profit margins by raising the selling prices of both Divisions and by improving the products' mix.

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

Selling, marketing, research and development, administration, general and other expenses totaled US$ 68.8 million (24.0% of sales) in 2006, compared with US$ 60.8 million (25.0% of sales) during the same period in 2005. The increase in expenses is mainly the result of the addition of Nesse's activity, which was acquired in January 2006, and the addition of the Acatris activity in October 2006.

In accordance with the agreement for the acquisition of the Food Systems activity from IFF, during 2006 the Company recorded income of US$ 2.2 million (of which US$ 0.6 million was recorded in the fourth quarter) under other income for monies expected from IFF in accordance with the earn out mechanism in the agreement. In 2005 the Company recorded income of US$ 1.5 million (of which US$ 0.8 million was recorded in the fourth quarter) under the same earn out mechanism.

Operating Profit

During 2006, operating profit rose 9.8% to reach US$ 37.1 million compared with US$ 33.7 million in 2005. Operating margin for the period reached 12.9% compared with 13.8% during 2005. The decline in operating margin is influenced by the decrease in gross profitability, as mentioned above.

Finance Expenses and Income

Finance expenses for 2006 totaled US$ 0.4 million (0.1% of sales), similar to the finance expenses of US$ 0.4 million (0.2% of sales) in 2005.

Profit before Tax

Profit before tax for 2006 rose 9.9% to total US$ 36.6 million (12.7% of sales) compared with US$ 33.3 million (13.7% of sales) during 2005.

Taxes on Income

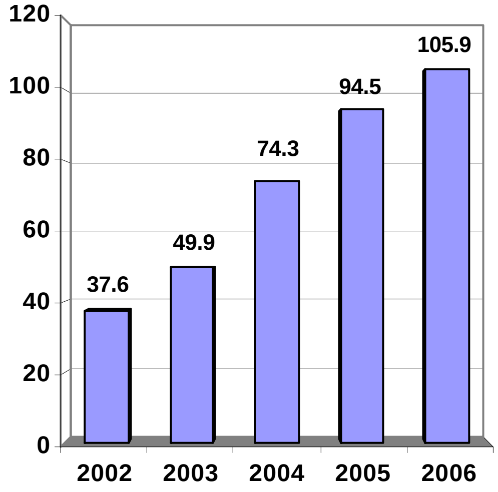
Taxes on income in 2006 totaled US$ 6.9 million (18.9% of profit before tax), compared with US$ 6.5 million (19.4% of profit before tax) during 2005. The rate of taxes on income as a percentage of profit before tax in 2006 was influenced by the following one time factors: (1) tax arrangements made in Germany following the Nesse acquisition in January 2006 that resulted in tax savings of US$ 1.5 million in 2006; (2) tax benefits recorded by the Company during 2006 for previous periods upon receiving approval as a plant characterized by high technological turnover, leading to tax savings of US$ 1.0 million; and on the other hand, (3) a tax benefit in the amount of US$ 1.7 million recorded by the Company in 2005 for previous periods. The cumulative influence of these one time factors in 2005 and 2006 resulted in reduced taxes on income for 2006 compared with 2005 in the net amount of US$ 0.8 million and to a reduction in the tax rate as a percentage of profit before tax.

Net Profit

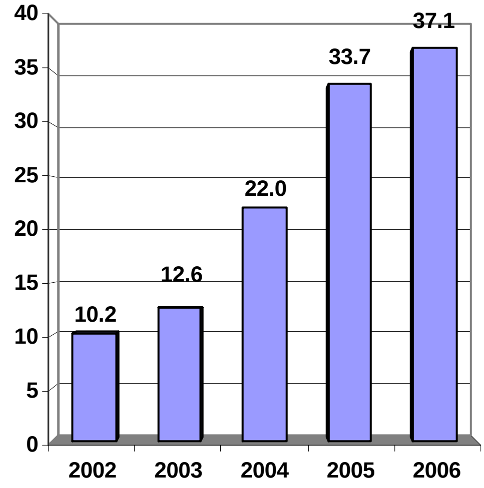
Net profit for 2006 rose 10.6% to total US$ 29.7 million compared with US$ 26.8 million in 2005. Net margin was 10.3% compared with 11.0% in 2005.

Profit Development in 2002-2006 (US$ millions)

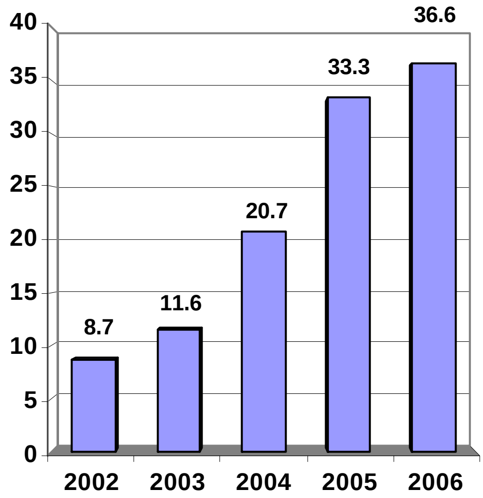
Gross Profit



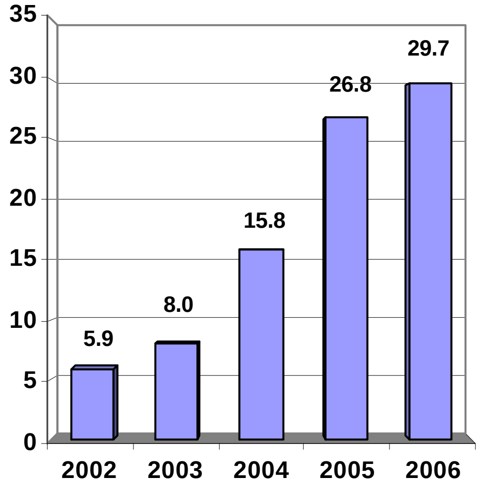
Operating Profit



Profit before Tax



Net Profit



Results of Activity in the Fourth Quarter of 2006

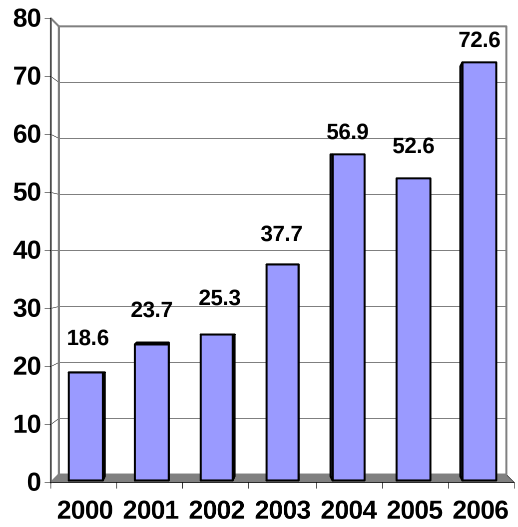
Following is a summary of the profit and loss report for the fourth quarter (US$ millions):

	2005	2006	Change (%)
Sales	52.6	72.6	38.1%
Gross profit	19.6	25.7	31.1%
R&D, Selling, Administration, General and Other income	14.6	17.9	22.6%
Operating profit	5.0	7.8	56.0%
EBITDA	7.1	11.4	59.7%
Profit before tax	5.0	7.7	53.3%
Net profit	4.9	5.3	9.1%

Sales

Frutarom's sales during the fourth quarter of 2006 totaled US$ 72.6 million, showing growth of 38.1% compared with the same period in 2005.

Sales Development in the Fourth 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 as of January 2006 with the Frutarom Group's global activity.

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

C. The integration of Acatris's activity, which was acquired and consolidated as of October 2006 with the Frutarom Group's global activity.

D. Growth in the sales of the Fine Ingredients Division, deriving, among others, from the introduction of new products developed in the Company's laboratories.

E. 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.

F. Strengthening of the West European currencies (in which most of Frutarom's sales are made) compared with the US dollar contributed 4% to the growth in sales.

The increase in sales was somewhat offset by a decline, compared with the same period in 2005, in the prices of natural products sold by Frutarom's Fine Ingredients Division to the food, flavor and fragrance industries (mainly grapefruit and natural gums), and in the selling prices of flavor compounds produced by the Flavors Division using these 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.

Gross Profit

Gross profit grew 31.1% during the fourth quarter of 2006 to reach US$ 25.7 million compared with US$ 19.6 million in the same period of 2005. Gross margin was 35.3% during the quarter compared with 37.2% during the same period in 2005. The decline in profitability during the fourth quarter derives from the acquisitions of Nesse and Acatris, which contributed to the growth in gross profit but which due to their having a lower gross profitability than Frutarom average, brought about a reduction in the rate of gross profitability. Similarly, Frutarom Israel's Trade & Marketing activity (which has a significantly lower margin than the average for Frutarom, and is not regarded as a core activity for the Company) also influenced gross profitability.

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

Selling, marketing, research and development, administration, general and other income totaled US$ 17.9 million (24.7% of sales) in the fourth quarter of 2006, compared with US$ 14.6 million (27.7% of sales) during the same period of 2005. The increase in expenses is mainly the result of the addition of the Nesse and Acatris activities, acquired in January and October 2006, respectively; the increased activity; and the strengthening of the West European currencies against the US dollar.

In accordance with the agreement for the acquisition of the Food Systems activity from IFF, during the fourth quarter the Company recorded income of US$ 0.6 million under other income for monies expected from IFF in accordance with the earn out mechanism in the agreement. During the same quarter in 2005, the Company recorded income of US$ 0.8 million from the earn out mechanism mentioned above.

Operating Profit

During the fourth quarter of 2006, operating profit rose 56.0% to total US$ 7.8 million compared with US$ 5.0 million in the same period of 2005. Operating margin for the period reached 10.6% compared with 9.5% during the same period in 2005. Operating margin improved during the fourth quarter of 2006 mainly due to the organic growth in activity and the synergy achieved between the Company's activities.

Finance Expenses

Finance expenses for the fourth quarter of 2006 totaled US$ 0.1 million (0.1% of sales), similar to the fourth quarter of 2005.

Profit before Tax

Profit before tax for the fourth quarter of 2006 rose 53.3% to total US$ 7.7 million, constituting 10.6% of sales, compared with US$ 5.0 million, which constituted 9.5% of sales during the same period in 2005.

Taxes on Income

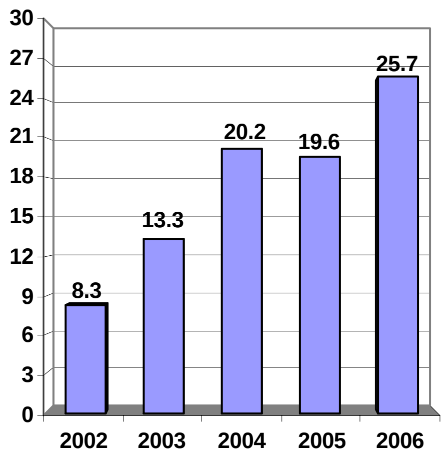
Taxes on income in the fourth quarter of 2006 totaled US$ 2.3 million (30.6% of profit before tax) compared with only US$ 0.1 million (2.5% of profit before tax) during the same period in 2005. The increase in taxes on income compared with the same quarter in 2005 results from a one time tax benefit in the amount of US$ 0.7 million recorded during the fourth quarter of 2005 for previous years, due to receiving approval as a plant characterized by high technological turnover, and from the decrease in Israel's statutory tax rate recorded during the fourth quarter of 2005 that reduced the Company's liability for deferred tax.

Net Profit

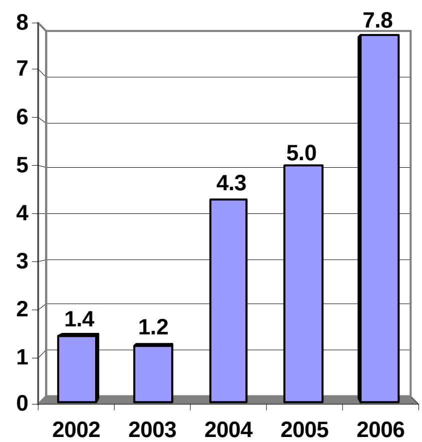
Net profit for the fourth quarter of 2006 grew 9.1% totaled US$ 5.3 million compared with US$ 4.9 million in the same period of 2005. Net margin reached 7.4% compared with 9.3% in the first nine months of 2005. The decline in the rate of net profitability, despite improvement in operating margin, derives from rise in taxes on income mentioned above.

Profit Development in 2002-2006 (US$ millions)

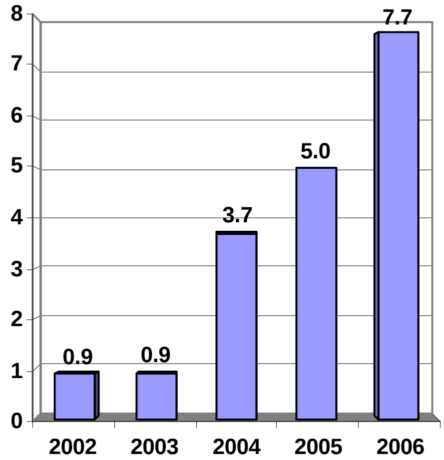
Gross Profit



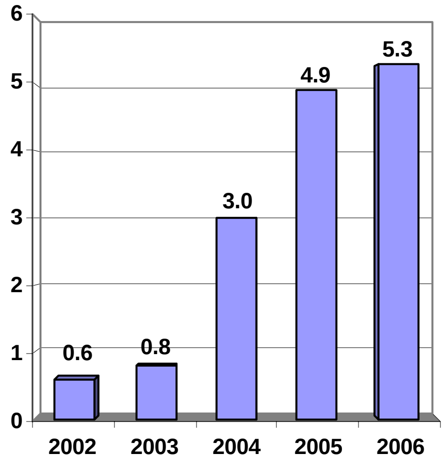
Operating Profit



Profit before Tax



Net Profit



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

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006
Sales	64.7	67.1	59.4	52.6	71.0	72.3	71.3	72.6
Gross profit	25.0	26.9	23.0	19.6	27.0	26.3	26.9	25.7
Selling, Marketing, R&D, Administration, General and Other Expenses	15.7	15.4	15.1	14.6	16.7	16.6	17.7	17.9
Operating profit	9.3	11.6	7.9	5.0	10.4	9.7	9.2	7.8
EBITDA	11.8	13.8	10.2	7.1	12.9	12.5	11.8	11.4
Finance expenses	0.2	0.2	0.1	--	-0.3	0.6	0.1	0.1
Profit before tax	9.1	11.4	7.9	5.0	10.7	9.1	9.2	7.7
Net profit	6.8	8.4	6.8	4.9	8.8	8.6	7.0	5.3

Frutarom's business is characterized by 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.

The impact of seasonality on the Company's results has weakened 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 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 reduce the effect of seasonality. The products of Acatris Health, whose acquisition was completed at the beginning of October 2006 are also expected to contribute to modifying the seasonality of sales.

Financial Status

Total assets on December 31, 2006 amounted to US$ 316.7 million compared with US$ 233.9 million at December 31, 2005.

The Company's current assets totaled US$ 149.1 million compared with US$ 129.9 million at December 31, 2005.

Fixed assets minus accumulated depreciation and net other assets totaled US$ 161.8 million on December 31, 2006, compared with US$ 98.7 million at December 31, 2005.

The growth in overall assets, and particularly in current assets, resulted mainly from the addition of the Nesse and Acatris assets following their acquisition in January and October 2006, respectively.

Liquidity

The cash flow from current activities achieved by Frutarom during 2006 totaled US$ 31.4 million compared with US$ 32.5 million in 2005.

The cash flow from current activities achieved by Frutarom during the fourth quarter of 2006 totaled US$ 9.1 million compared with US$ 5.6 million in the same period of 2005.

Sources of Finance

Sources of the Company's Shareholders' Equity

The Company's shareholders' equity at December 31, 2006 totaled US$ 217.1 million (68.5% of the balance sheet) compared with US$ 177.8 million (76.0% of the balance sheet) at December 31, 2005. Most of the increase in shareholders' equity resulted from the profit achieved during the period and the positive change in the equity fund from translation differences following the strengthening of the West European currencies against the US dollar.

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

The Company did not require any long term credit from banks during 2006. In 2005, the Company had US$ 10.1 million at its disposal.

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

Short term credit from banks totaled US$ 0.7 million. In 2005, the Company had US$ 4.2 million at its disposal.

Credit from Suppliers and to Customers (Annual Average)

During 2006 the average scope of credit from suppliers and other creditors was US$ 49.6 million (compared with US$ 43.7 million during 2005). During 2006, the Company granted average credit of US$ 53.3 million to its customers (compared with US$ 46.5 million in 2005). Most of the growth in suppliers' and customers' credit results from the acquisition of Nesse in January 2006 and of Acatris in October 2006.

Disclosures about Market Risk

General

The Company's activity is characterized by significant dispersal. Through its two Divisions, the Company produces thousands of products intended for thousands of customers throughout the world, using thousands of raw materials purchased from a wide range of suppliers worldwide. The Company's activity is not characterized by significant customer, product or supplier concentration.

Responsibility for the Company's Market Risk Management

The Company's Chief Financial Officer is responsible for managing market risk as it relates to currency 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 Euros. The fact that raw material purchases for Frutarom's production are also conducted in various currencies reduces currency exposure. Most of the non dollar monetary balances derive from the local activity of the subsidiaries in Europe. The functional currency of these companies is the local currency, and therefore the currency translations of these balances do not influence the Company's finance expenses and are recognized as a currency translation capital fund. 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 sources of bank finance, short and long term, to the extent necessary, are linked to the US dollar, the pound Sterling, the Swiss franc, and the Euro (according to the currency in which the subsidiary is active) and bear variable Libor interest. The Company's policy is not to take protective steps against possible interest rises. As of the balance sheet date the Company did not hold any derivative securities, did not have any long term debt and its short term debt was not substantial.

<u>The Company's Policy Regarding Risk Management</u>

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 2006 there were no changes to the risk management policy.

<u>Supervision of Risk Management Policy and its Implementation</u>

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 2006 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, 2006 (in US$ 000)

	US$	GBP	Euro	CHF	Other currencies	NIS	Total
Assets							
Cash and Equivalents, Short term investment	6,333	843	11,326	2,034	806	335	21,677
Customers	14,946	4,899	16,855	4,489	1,296	11,483	53,968
Other Debtors	3,523	1,420	4,492	2,269	447	1,549	13,700
Inventory	29,774	5,932	10,640	13,408			59,754
Other long term debtors	3,832		1,939				5,771
Fixed assets, net	29,418	6,890	17,979	46,628	740		101,655
Other assets, net	2,566	6,868	44,428	6,310			60,172
Total Assets	**90,392**	**26,852**	**107,659**	**75,138**	**3,289**	**13,367**	**316,697**
Liabilities							
Bank loans			673				673
Suppliers	4,322	2,609	9,419	5,601	56	5,493	27,500
Other creditors	3,423	1,568	3,819	8,249	67	11,817	28,943
Other long term liabilities			22,708				22,708
Employee retirement rights liabilities	669		5,925	905			7,499
Deferred taxes	2,490	1,595	4,329	3,827			12,241
Total Liabilities	10,904	5,772	46,873	18,582	123	17,310	99,564
Shareholders' Equity							217,133
Net Assets (Liabilities)	79,488	21,080	60,786	56,556	3,166	-3,943	0

Sensitivity to Changes in the US Dollar-New Israeli Shekel Exchange Rate

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
Exchange rate	**4.648**	**4.436**	**4.225**	**4.015**	**3.803**
			US$ 000		
Cash and Equivalents	(34)	(17)	335	17	34
Customers	(1,148)	(574)	11,483	574	1,148
Other Debtors	(155)	(77)	1,549	77	155
	(1,337)	**(668)**	**13,367**	**668**	**1,337**
Suppliers and Service providers	549	275	5,493	(275)	(549)
Other creditors	1,182	591	11,817	(591)	(1,182)
	1,731	**866**	**17,310**	**(866)**	**(1,731)**
Total exposure, net	**394**	**197**	**(3,943)**	**(197)**	**(394)**

Sensitivity to Changes in the US Dollar-Pound Sterling Exchange Rate

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
Exchange rate	**0.561**	**0.535**	**0.510**	**0.484**	**0.459**
	US$ 000				
Cash and Equivalents	(84)	(42)	843	42	84
Customers	(490)	(245)	4,899	245	490
Other Debtors	(101)	(51)	1,014	51	101
	(676)	**(338)**	**6,756**	**338**	**676**
Suppliers and Service providers	261	130	2,609	(130)	(261)
Other creditors	157	78	1,568	(78)	(157)
	418	**209**	**4,177**	**(209)**	**(418)**
Total exposure, net	**(258)**	**(129)**	**2,579**	**129**	**258**

Sensitivity to Changes in the US Dollar-Euro Exchange Rate

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
Exchange rate	**0.835**	**0.797**	**0.759**	**0.721**	**0.683**
	US$ 000				
Cash and Equivalents	(807)	(403)	8,066	403	807
Short term investments	(326)	(163)	3,260	163	326
Customers	(1,686)	(843)	16,855	843	1,686
Other Debtors	(403)	(201)	4,026	201	403
	(3,221)	**(1,610)**	**32,207**	**1,610**	**3,221**
Credit from banks	67	34	673	(34)	(67)
Suppliers and Service providers	942	471	9,419	(471)	(942)
Other creditors	382	191	3,819	(191)	(382)
Employee retirement rights liabilities	593	296	5,925	(296)	(593)
Other long term creditors	2,271	1,135	22,708	(1,135)	(2,271)
	4,254	**2,127**	**42,544**	**(2,127)**	**(4,254)**
Total exposure, net	**1,034**	**517**	**(10,337)**	**(517)**	**(1,034)**

Sensitivity to Changes in the US Dollar-Swiss Franc Exchange Rate

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
Exchange rate	**1.341**	**1.280**	**1.219**	**1.158**	**1.097**
			US$ 000		
Cash and Equivalents	(203)	(102)	2,034	102	203
Customers	(449)	(224)	4,489	224	449
Other Debtors	(153)	(77)	1,532	77	153
	(806)	**(403)**	**8,055**	**403**	**806**
Suppliers and Service providers	560	280	5,601	(280)	(560)
Other creditors	825	412	8,249	(412)	(825)
Employee retirement rights liabilities	91	45	905	(45)	(91)
	1,476	**738**	**14,755**	**(738)**	**(1,476)**
Total exposure, net	**670**	**335**	**(6,700)**	**(335)**	**(670)**

Sensitivity to Changes in the US Dollar-Other Currencies Exchange Rate

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
			US$ 000		
Cash and Equivalents	(81)	(40)	806	40	81
Customers	(130)	(65)	1,296	65	130
Other Debtors	(36)	(18)	363	18	36
	(247)	**(123)**	**2,465**	**123**	**247**
Suppliers and Service providers	6	3	56	(3)	(6)
Other creditors	7	3	67	(3)	(7)
	12	**6**	**123**	**(6)**	**(12)**
Total exposure, net	**(234)**	**(117)**	**2,342**	**117**	**234**

Sensitivity to Changes in the Interest Rate of the Euro

	Profit (Loss) from changes		Fair value	Profit (Loss) from changes	
% of change	**+10%**	**+5%**	**--**	**-5%**	**-10%**
Interest rate	**4.427%**	**4.226%**	**4.025%**	**3.824%**	**3.622%**
			US$ 000		
Liabilities for Nesse acquisition	**91**	**45**	**22,227**	**(46)**	**(92)**

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.

Auditor’s Compliance with Legal Requirements

The internal auditor meets the requirements of Section 146(b) of the Companies Law and of the instructions in Section 8 of the Internal Audit Law.

The Internal Auditor’s Relations with the Company

At the time of this report, the internal auditor did not hold shares in the Company.

The internal auditor does not have significant business or other relations with the Company.

The internal auditor is not an employee of the Company and does not fill other positions in the Company or provide additional external services.

Appointment of the Internal Auditor

The appointment of the internal auditor was approved by the Board of Directors of the Company on January 17, 2005 based on the recommendation of the Audit Committee.

The internal auditor’s appointment was approved by the Board of Directors of the Company after reviewing his education (CPA and economist) and his experience in the field of internal auditing and in various managerial posts including, among others, as internal auditor. The Board of Directors of the Company found the internal auditor to be suitable to fill this position in view of the Company’s size, scope of activity and level of complication.

Identification of the Internal Auditor's Superior

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

Audit Program

The audit program is an annual and multi-year program 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 of the Company. The considerations directing the program's preparation are based on subjects perceived as worthy of thorough analysis, according to their risk level, with the aim of locating faults, achieving efficiencies, and ensuring that the Company's assets are protected and 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. The audit is carried out in accordance with the annual and multi-year audit programs and is updated as need and as indicated by the findings of the audit. The audit is carried out through questionnaires and physical audits at the sites of the Company and related companies in Israel and throughout the world. Some of the audit subjects are wide-ranging and checked throughout the Group, while others are specific subjects audited according to the annual program.

Auditing Outside of Israel or of Related Companies

The annual audit program also encompasses significant undertakings of the Company. The internal auditor conducts at least one audit each year in each significant subsidiary.

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 at a rate of 1,200 working hours per year (equal to two and a half working days per week).

	Number of hours invested in internal auditing in the Company itself	Number of hours invested in internal auditing in related companies
Activity in Israel	500	0
Activity outside of Israel	0	700

The scope and level of complication of the Company’s activity were taken into account in determining the internal auditor’s scope of employment.

The internal auditor’s scope of employment did not change in 2006 as compared with 2005.

Drafting the Audit

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

Free Access for the Internal Auditor

The internal auditor has free and independent access to the Company's information systems, including those of the related companies, whether ordinary or computerized, to all data bases and to all programs for automatic data processing of the Company and its related companies, including financial data. The internal auditor is entitled to enter any and all assets of the Company, including its related companies, and check them.

The Internal Auditor’s Accountability

Audit reports are prepared and submitted in writing by the internal auditor to the Audit Committee and to the members of the Company’s management.

During 2006, three meetings were held (March 21, July 4 and November 26), at which 10 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.

Assessment by the Board of Directors of the Company of the Internal Auditor's Activity

In the opinion of the Board of Directors of the Company, the scope, character and continuity of the internal auditor's activity and work program are reasonable under the circumstances and fulfill the internal audit goals of the Company.

The internal auditor's compensation in 2006 was NIS 320,000. The Company does not believe that this compensation would affect the professional considerations of the internal auditor.

Allotment of Shares and Distribution of Dividend

As part of a material private offering and a non-material private offering the Company performed in January 2006, the Company allotted 725,000 non tradable options in accordance with Section 102(b)(3) of the Income Tax Order. Each option can be exercised into one ordinary share of the Company in consideration for NIS 31.068 per share and in total 725,000 shares in consideration for NIS 22,524,300.

On March 14, 2006, the Board of Directors of the Company declared the distribution of a cash dividend of NIS 0.16 per share, totaling NIS 9.2 million. April 9, 2006 was set as the record date and the dividend was distributed on April 24, 2005.

Critical Accounting Estimations

Preparation of the financial reports of the Company in accordance with IFRS demands that use of critical accounting estimates, which obliges the management of the Company to use its judgment in the process of implementing the general accounting policies of the Company, to 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 implementation, 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. Regarding the material accounting estimates used in preparing the financial reports of the Company, refer also to note 4 to the attached financial reports.

Taxes on Income and Deferred Taxes

The Company is assessed for tax purposes in numerous jurisdictions; accordingly, the Company's management is required to exercise judgment in order to determine the overall provision in respect of taxes on income. The Company makes many transactions for which the final tax determination is uncertain. The Company records provisions in its books based on its estimates of whether additional taxes will be due on these transactions. Where the final tax outcome of these matters as determined by the tax authorities is different from the amounts that were initially recorded, such differences will be carried to income and loss in the period in which the final tax assessment is determined by the tax authorities.

The Company also records deferred tax assets and liabilities based on the differences between the book value of its assets and liabilities and the amounts taken into account tax purposes. The Company regularly reviews its deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and the implementation of tax planning strategies. If the Company is unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, the Company could be required to eliminate a portion of the deferred tax asset resulting in an increase in its effective tax rate and an adverse impact on operating results.

Severance Pay

The present value of the Company's liabilities in respect of severance pay is dependent on several factors that are determined on an actuarial basis in accordance with various assumptions. The assumptions used in the calculation of the net cost (income) in respect of severance pay include the long term yield rate on the related severance pay funds and the rate of discount. Changes in those assumptions shall influence the carrying amount of the assets and liabilities in respect of severance pay. The assumption regarding the expected yield on severance pay funds is determined uniformly in accordance with long term historical yields.

The assumption regarding the required rate of discount is determined by external actuaries at the end of each year. This rate of discount shall be used in determining the estimated updated value of the future cash flows that would be required to cover the severance pay liabilities. The liquidity of the market of high quality corporate bonds is not sufficient to serve as the basis for determining the discount rate. Therefore, in determining this rate the Company uses interest rates applicable to governmental bonds denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related liability.

Other key assumptions relating to pension liabilities, such as future payroll raises, are based on existing rates of payroll inflation.

Provision for Contingent Liabilities

Contingent provisions for legal liabilities are recorded in the books in accordance with the judgment of the Company's management regarding the likelihood that the cash flows will be used to meet the liabilities, and on the basis of the estimate determined by the management regarding the present value of the expected cash flows that would be required to meet the existing liabilities.

Provision for Impairment in Respect of Goodwill and Intangibles

Once a year, the Company reviews the need to provide for impairment of goodwill and intangibles. The need to make such a provision is assessed in relation to the recoverable value of the cash generating units of the Company. The recoverable amount of a cash generating unit is determined in accordance with the assumptions and calculations made by management.

Directors with Accounting and Financial Expertise

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 Inc. 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 Inc. Mr. Oram, a fellow of the Institute of Chartered Accountants in England and Wales, qualified in 1967.

Mr. Hans Abderhalden – Mr. Abderhalden has served as a director on the board of directors of Frutarom since December 2004. In addition, Mr. Abderhalden has also served as director on the board of directors of Frutarom Switzerland since 2002. 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 for a period of 18 years, including as president of the global flavors division.

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 (Profit Sharing Life Insurance) 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 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 as 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.

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 capital 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.

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 2006 is US$ 551,000 for Israel and for the overseas subsidiaries (6,293 hours). 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 2006 is US$ 49,000 for Israel and for the overseas subsidiaries.

Events Following the Balance Sheet Date

On March 19, 2007, upon approval of the annual financial reports, the Board of Directors of the Company resolved to distribute a cash dividend in the amount of NIS 0.18 per share for an overall total of NIS 10.4 million.

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

The Board of Directors of the Company held seven meetings during 2006.

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 19, 2007