FRUTAROM INDUSTRIES LTD.

2006 CONSOLIDATED FINANCIAL STATEMENTS

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PRICEWATERHOUSECOOPERS

Kesselman & Kesselman
Certified Public Accountants (Isr.)
1 Nathanson Street
Haifa 33034 Israel
Telephone +972-4-8605000
Facsimile +972-4-8605001

REPORT OF THE AUDITORS

To the shareholders of

FRUTAROM INDUSTRIES LTD.

We have audited the accompanying consolidated financial statements of Frutarom Industries Ltd. (hereafter - the Company) and its subsidiaries; balance sheets as of 31 December 2006, 2005 and 2004 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended 31 December 2006. These consolidated financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We did not audit the financial statements of certain consolidated companies, whose assets included in consolidation constitute approximately 4%, 4% and 4% of total consolidated assets as of 31 December 2006, 2005 and 2004, and whose revenues included in consolidation constitute approximately 7%, 7%, and 10% of total consolidated revenues for the years ended 31 December 2006, 2005 and 2004, respectively. The financial statements of the above consolidated companies were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for these companies, is based on reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in Israel, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Group as of 31 December 2006, 2005 and 2004 and the results of operations, changes in shareholders' equity and cash flows for each of the years in the period ended December 31, 2006, in accordance with International Financial Reporting Standards.

Haifa, Israel
19 March 2007

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED BALANCE SHEETS

	Note	As of 31 December 2006	2005	2004
		U.S. dollars in thousands		
A s s e t s	14			
CURRENT ASSETS:	3a1)			
Cash and cash equivalents	18	18,417	33,723	7,350
Short term investments	5c	3,260		
Accounts receivable:	15			
Trade		53,968	40,289	43,733
Other		10,038	6,756	7,291
Prepaid expenses and advances to suppliers		3,662	2,206	1,851
Inventories	16	59,754	46,886	43,769
T o t a l current assets		149,099	129,860	103,994
NON-CURRENT ASSETS :				
Property, plant and equipment - net	7	101,655	*86,108	96,683
Intangible assets - net	2f,8	60,172	*12,601	5,348
Deferred income tax assets	13e	3,833	3,319	2,957
Other non-current assets	17	1,938	1,978	4,758
T o t a l non-current assets		167,598	104,006	109,746
T o t a l non-current assets		316,697	233,866	213,740

* Reclassified.

______________________)
Dr. John J. Farber)
Chairman of the Board

______________________)
Ori Yehudai)
President and CEO

______________________)
Alon Granot)
Executive Vice President and CFO

Date of approval of the financial statements by the Board of Directors: 19 March 2007.

	Note	As of 31 December 2006	2005	2004
		U.S. dollars in thousands		
Liabilities and Shareholders' Equity				
CURRENT LIABILITIES:	3a1)			
Bank credit and loans	19	673	289	50,355
Accounts payable:	20			
Trade		27,500	17,895	20,257
Other		27,997	22,162	20,718
Provisions	21	946	547	1,193
Total current liabilities		57,116	40,893	92,523
NON-CURRENT LIABILITIES:				
Loans and credit from banks (net of current maturities)	9			29,831
Retirement benefit obligations	10	7,499	7,775	8,502
Deferred income tax liabilities	13e	12,241	7,390	4,231
Others	5c	22,708		
Total non-current liabilities		42,448	15,165	42,564
COMMITMENTS AND CONTINGENT LIABILITIES	11			
Total liabilities		99,564	56,058	135,087
SHAREHOLDERS' EQUITY:	12			
Share capital		16,434	16,399	13,961
Capital surplus		93,116	91,666	17,642
Currency translation differences	2c	5,716	(5,160)	5,039
Retained earnings		103,658	75,934	43,072
Net of - cost of Company shares held by subsidiary		(1,791)	(1,031)	(1,061)
Total shareholders' equity		217,133	177,808	78,653
Total shareholders' equity and liabilities		316,697	233,866	213,740

The accompanying notes are an integral part of the financial statements.

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED INCOME STATEMENTS

	Note	2006	2005	2004
		Year ended 31 December		
		U.S. dollars in thousands, except for per share data		
SALES		287,247	243,803	196,780
COST OF SALES	22a	181,370	149,285	122,447
GROSS PROFIT		105,877	94,518	74,333
SELLING, MARKETING, RESEARCH AND DEVELOPMENT, GENERAL AND ADMINISTRATIVE EXPENSES - net:				
Selling, marketing, research and development - net	22b	48,518	43,818	34,554
General and administrative	22c	22,418	18,217	17,869
OTHER INCOME - net	22d	2,114	1,255	102
OPERATING PROFIT		37,055	33,738	22,012
FINANCIAL EXPENSES - net	22e	445	416	1,347
PROFIT BEFORE TAXES ON INCOME		36,610	33,322	20,665
TAXES ON INCOME	13f	6,908	6,475	4,909
NET INCOME		29,702	26,847	15,756
		U.S dollars		
EARNINGS PER SHARE:	2r			
BASIC		0.52	0.49	0.34
DILUTED		0.51	0.48	0.33

The accompanying notes are an integral part of the financial statements.

FRUTAROM INDUSTRIES LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Note	Share capital	Capital surplus	Currency translation differences	Retained earnings	Cost of company shares held by subsidiary	Total
		U.S. dollars in thousands					
BALANCE AT 1 JANUARY 2004		13,939	15,263	2,563	28,460	(600)	59,625
CHANGES IN 2004:							
Net income not recognized in the net profit - changes in currency translation	2c			2,476			2,476
Net income					15,756		15,756
Total recognised income for 2004							18,232
Plan for allotment of Company shares to employees:	2L						
Purchase of Company shares by subsidiary						(991)	(991)
Receipts in respect of allotment of Company shares to employees	12c3)					90	90
Recognition of compensation related to the plan						440	440
Allotment of shares and options to senior employees:	12d;12c3)						
Allotment of share capital to senior employees		22	89				111
Recognition of compensation related to employee stock and option grants			2,290				2,290
Dividend	12e				(1,144)		(1,144)
BALANCE AT 31 DECEMBER 2004 - brought forward		13,961	17,642	5,039	43,072	(1,061)	78,653

FRUTAROM INDUSTRIES LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Note	Share capital	Capital surplus	Currency translation differences	Retained earnings	Cost of company shares held by subsidiary	Total
		U.S. dollars in thousands					
BALANCE AT 1 JANUARY 2005 - brought forward		13,961	17,642	5,039	43,072	(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 (Note 2f)					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	50,803	(1,061)	86,384
CHANGES IN 2005:							
Net income not recognised in the net profit - changes in currency translation	2c			(10,199)			(10,199)
Net income					26,847		26,847
Total recognised income for 2005							16,648
Issuance of share capital	12b	2,416	73,451				75,867
Plan for allotment of Company shares to employees of subsidiary:	2L						
Purchase of Company shares by subsidiary						(383)	(383)
Receipts in respect of allotment of Company shares to employees	12c3)					92	92
Recognition of compensation related to the plan	12c3)					321	321
Allotment of shares and options to senior employees:	12d;12c3)						
Allotment of share capital to senior employees		22	89				111
Recognition of compensation related to employee stock and option grants			484				484
Dividend	12e				(1,716)		(1,716)
BALANCE AT 31 DECEMBER 2005 - brought forward		16,399	91,666	(5,160)	75,934	(1,031)	177,808

FRUTAROM INDUSTRIES LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Note	Share capital	Capital surplus	Currency translation differences	Retained earnings	Cost of company shares held by subsidiary	Total
		U.S. dollars in thousands					
BALANCE AT 31 DECEMBER 2005		16,399	91,666	(5,160)	75,934	(1,031)	177,808
CHANGES IN 2006:							
Net income not recognised in the net profit - changes in currency translation	2c			10,876			10,876
Net income					29,702		29,702
Total recognised income for 2006							40,578
Plan for allotment of Company shares to employees of subsidiary:	2L						
Purchase of Company shares by subsidiary						(1,135)	(1,135)
Receipts in respect of allotment of Company shares to employees	12c3)					146	146
Recognition of compensation related to the plan	12c3)					229	229
Allotment of share and options to senior employees	12d;12c3)						
Allotment of share capital to senior employees		35	141				176
Recognition of compensation related to employee stock and options grants			1,309				1,309
Dividend paid	12e				(1,978)		(1,978)
BALANCE AT 31 DECEMBER 2006		16,434	93,116	5,716	103,658	(1,791)	217,133

The accompanying notes are an integral part of the financial statements.

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	2006	2005	2004
		Year ended 31 December		
		U.S. dollars in thousands		
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash generated from operations	23	36,389	34,431	21,028
Interest received (paid)		400	222	(1,334)
Income tax paid		(5,340)	(2,203)	(2,423)
Net cash provided by operating activities		31,449	32,450	17,271
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property, plant and equipment		(10,056)	*(10,100)	(5,960)
Acquisition of subsidiaries - net of cash acquired	5a;d	(34,390)		
Acquisition of operations – net of cash acquired	5b			(38,209)
Reimbursement in respect of acquisition of operation	5b	2,218	4,598	
Proceeds from sale of property, plant and equipment		426	4,095	201
Purchase of other assets		(3,820)	*(2,233)	
Collection of long-term receivable	17		2,439	
Capitalised lease fees	17		(382)	
Acquisition of short-term marketable securities – net		7		
Net cash used in investing activities		(45,615)	(1,583)	(43,968)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Issuance of share capital, net of issuance costs			75,867	
Receipts from senior employees in respect of allotment of shares		176	111	111
Receipt of long-term bank loans and credit				3,082
Repayment of long-term bank loans and credit		(304)	(33,585)	(11,014)
Receipt of short-term bank loans				37,789
Repayment of long-term credit in connection with the acquisition of Flachsmann	5a		(1,170)	(1,202)
Purchase of Company shares by subsidiary – net of receipts in respect of the shares		(989)	(291)	(901)
Repayment of long-term credit in connection with the acquisition of IFF			(39,468)	
Dividend paid		(1,978)	(1,716)	(1,144)
Net cash provided by (used in) financing activities		(3,095)	(252)	26,721
NET EFFECT OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS		1,282	(1,011)	6
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(15,979)	29,604	30
BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		33,723	4,119	4,089
BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR	18	17,744	33,723	4,119

* Reclassified.

The accompanying notes are an integral part of the financial statements.

NOTE 1 – GENERAL INFORMATION:

a. Information on the activities of Frutarom Industries Ltd. and its subsidiaries (hereafter - the "Group").

Frutarom Indusrties Ltd. is a global company, founded in 1933. The Company operates through the consolidated company (hereafter - Frutarom Ltd.) and the companies under its control. The Group operates principally in two divisions: the Flavors Division and the Fine Ingredients Division. The Group develops, manufactures, markets and sells flavors and fine ingredients used by producers of food and beverage, pharma-nutraceutical, flavours and fragrances, and personal care and cosmetics products as well as other products. The Company has production facilities in Europe, North America, Israel, and Asia (see also a list of subsidiaries in Note 27); The Company has 22 research and development laboratories and it sells and markets its products principally through its 45 sales and marketing offices. Segment information for the reporting years is presented as part of Note 6.

The Company is a limited liability company incorporated and domiciled in Israel. The address of its registered office is 25 Heshaish St., Haifa Bay. The Company's controlling shareholder is ICC Industries Inc.

The Company's shares have been listed on the Tel-Aviv Stock Exchange (the "TASE") since 1996; since February 2005, Company's shares are also listed through Global Depository Receipts in the official list of the London Stock Exchange (the "LSE") (b. below).

b. In February 2005, the Company has completed a public offering in which it raised capital in the total amount of $ 76 million (net of issuance expenses at the amount of $ 5 million) as against the issuance of Company shares and listing Global Depositary Receipts (hereafter – GDRs) in the official list of the London Stock Exchange (hereafter – LSE) (Note 12b).

c. Material Acquisitions made by the group:

1) In 2004, the group completed the purchase of the Food Systems Business (hereafter – FS) of International Flavors & Fragrances I.F.F. Inc. (hereafter – IFF) in Switzerland and Germany in consideration for approximately $ 31.8 million (approximately € 25.8 million) and in France in consideration for approximately $ 3 million (approximately € 2.5 million). IFF's FS business includes the development and production of unique fruit compounds and other natural products used as natural flavors in the production of a wide variety of food products. As to the data included in the consolidated financial statements as a result of the consolidation, for the first time, of the FS operations in Switzerland and Germany (commencing 17 August 2004) and in France (commencing 2 November 2004) (Note 5b).

2) In January 2006, the Group acquired 70% of the control in GewürzMühle Nesse GmbH and in GewürzMühle Nesse Gebr. Krause GmbH (hereafter together - Nesse), in consideration for € 18.4 million ($ 22.3 million) paid in cash. As to the data included in the consolidated financial statements as a result of the consolidation, for the first time, of Nesse (commencing 1 January 2006) (Note 5c).

3) In October 2006, the Group acquired 100% of the issued and paid share capital of the U.S. company Acatris Inc., of the Dutch company, Acatris Specialties Holdings B.V. and of the Belgian company, Acatris Belgium N.V. (hereafter together - Acatris), in consideration for € 10.5 million ($ 13.3 million) paid in cash. As to the data included in the consolidated financial statements as a result of the consolidation, for the first time, of Acatris (commencing 1 October 2006) (Note 5d).
As to further details regarding those acquisitions (Note 5).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

a. Basis of Preparation:

1) The consolidated financial statements of the group have been prepared in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Israeli Securities (Preparation of Annual Financial Statements), Regulations, 1993.

The consolidated financial statements have been prepared under the historical cost convention, subject to adjustments of the financial assets and liabilities to their fair value and revaluation of the liability for severance pay and the assets of the severance pay funds.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

2) Adoption of new standards

(a) Standards, Amendments and Interpretations that are Effective in 2006 but not relevant to the Group:

IAS 19 Actuarial gains and losses, group plans and disclosures.
IAS 39 (Amendment), Cash Flow Hedges for Forecast Intragroup Transactions.
IAS 39 (Amendment), The Fair Value Option.
IAS 39 and IFRS 4 (Amendment) Financial Guarantee Contracts.
IAS 21 (Amendment) Investment (net) 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.

(b) Standards and Interpretations to existing standards that are not yet effective and for which the Group has not opted early adoption:

1) IFRIC 10 - Interim Financial Reporting and Impairment, effective for annual periods beginning on or after 1 November 2006.

2) IFRS 7 - Financial Instruments – Disclosures – in effect for annual reporting periods commencing 1 January, 2007.

3) IFRS 8 - Operating segments, in effect for annual reporting periods commencing 1 January 2009.

4) IFRS 11 – IFRS 2 – Group and Treasury Share Transactions, in effect for annual reporting period commencing 1 March 2007.

The Group does not anticipate that the adaptation would have an impact on its financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

(c) Standards and Interpretations for existing Standards that are not yet effective and are not relevant to Group's operating:

IFRIC 7 - Applying the Restatement Approach under IAS 29, in effect for annual reporting periods commencing 1 March, 2006.
IFRIC 8 – Scope of IFRS 2 – in effect for annual reporting periods commencing 1 May, 2006.
IFRIC 9 – Reassessment of Embedded Derivatives – in effect for annual reporting periods commencing 1 September, 2006.
IAS 1 – Presentation of Financial Statements – Disclosure about Capital – in effect for annual reporting periods commencing 1 January, 2007.

b. Principles of Consolidation:

1) Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date the control ceases.

Effective 31 March, 2004, the Group applies the provisions of IFRS 3 "Business Combinations", simultaneously with the adoption of IAS 36 and IAS 38 (as revised in 2004).

This standard applies as from the effective date above, to all business combinations for which the agreement date is on or after 31 March 2004. Transition provisions apply to business combinations that were entered into before the effective date.

This standard also sets forth additional guidance and comprehensive criteria for the initial identification and recognition of intangible assets and contingent liabilities of businesses acquired (Note 2f).

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Company's share of the identifiable net assets acquired is recorded as goodwill.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the accounting treatment will be as follows:

1) For business combinations for which the agreement dates were before 31 March 2004 - the difference is presented as a deduction from intangible assets, and recognised as income on a systematic basis; this treatment applied until 31 December 2004 (Note 2f).

2) For business combination for which the agreement date was after 31 March 2004 – the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered as an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

2) As part of the condensed company data, the investment in Frutarom Ltd. is presented at cost (Note 26).

c. Foreign Currency Translation:

1) Functional and Presentation Currency.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "Functional Currency"). The consolidated financial statements are presented in U.S. dollars, which is the Company's functional and presentation currency.

2) Translation of transactions and balances.

Foreign currency transactions are translated into the Functional Currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

3) Group Companies.

The results and financial position of all the Company's entities (none of which has the currency of hyperinflationary economy) that have a Functional Currency different from the presentation currency are translated into the presentation currency as follows:

(a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
(b) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates);
(c) all resulting exchange differences, are recognised as a separate component of shareholders' equity.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, (including long-term borrowings thereto) are taken to shareholders' equity.

When a foreign operation is sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.
Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

d. Segment Reporting:

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The Group is organised on a worldwide basis into two major operating activities: the Flavors division, the Fine Ingredients division. Another operating activity is the Trade and Marketing division. Each division is considered to be a business segment.

e. Property, Plant and Equipment:

1) These assets are initially recorded at cost of purchase (Note 2c2)), net of related government grant.

Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

2) The assets are depreciated by the straight-line method, on basis of their estimated useful life, except for land, which is not depreciated.

Annual rates of depreciation are as follows:

	%
Buildings	2.7-4
Machinery and equipment	6.6-10
Vehicles and forklifts	15; 20
Computers	20-33
Office furniture and equipment	6-20

Leasehold improvements are amortised by the straight-line method over the terms of the lease, which are shorter than the estimated useful life of the improvements.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2g).

3) Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

f. Intangible Assets:

Effective 31 March 2004, the Group applies the provisions of IFRS 3 "Business Combinations" (Note 2b). This standard sets forth guidance and comprehensive criteria for the initial identification and recognition of intangible assets and contingent liabilities of businesses acquired.

This standard applies as from the effective date and onward, to all business combinations for which the agreement date is on or after 31 March 2004 (the "effective date").

1) Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary at the date of acquisition; when cost of acquisition is lower than the said fair value, the difference represents Negative Goodwill. Goodwill on acquisitions of subsidiaries is included in intangible assets.

The accounting treatment to be applied to goodwill or negative goodwill is as follows:

(a) For business combinations for which the agreement date was before the effective date and through 31 December 2004; Goodwill was amortised on a straight-line basis over the estimated useful life in equal annual installments at the rate no lower than 5% per annum, commencing on the date of acquisition. Negative goodwill was presented as a deduction from intangible assets, and recognised as income on a systematic basis, over the remaining weighted average useful life of the identified acquired depreciable assets.

In accordance with the transition provisions of IFRS 3, commencing 1 January, 2005, the Group ceased to amortise any existing goodwill arising from such business combinations (accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill), and de-recognised the balance of any remaining negative goodwill - amounting to $ 7,731 thousands (net of deferred taxes de-recognised amounting to $ 1,785 thousands), with a corresponding adjustment to the opening balance of retained earnings.

Separately recognised goodwill is tested for impairment commencing 2005. Goodwill is allocated to cash generating units for the purpose of the impairment testing.

(b) For business combinations for which the agreement dates were after the effective date - Goodwill and indefinite live intangible assets are not amortised, but are subject to annual impairment test. Goodwill is being tested for impairment on an annual basis, as well as when there are indications of impairment. Goodwill is carried at cost less accumulated impairment losses.

Negative goodwill is directly recognised in the income statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

2) Product formulas are initially recorded at their acquisition cost and amortised on a straight-line basis over 10-20 years (mainly 20 years), commencing in the year in which they are first utilized.

3) Customer relations are initially recorded at their acquisition cost and amortised on a straight-line basis over 10 years.

4) Trademark is initially recorded at the acquisition cost and amortised on a straight-line basis over 20 years.

5) Acquired computer software licences are presented on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (three to five years).

   Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the employee costs incurred as a result of developing software and an appropriate portion of relevant overheads.

   Computer software development costs recognised as assets are amortised over their estimated useful lives (not exceeding three years).

g. Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).
Non-financial assets, other than goodwill, that were subject to impairment are reviewed for possible reversal of the impairment at each reporting date.

h. Financial assets:

The Group classifies its financial assets in the following categories: at fair value through profit or loss and loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

1) Financial assets at fair value through profit or loss.
   Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Assets in this category are classified as current assets.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

2) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2j).

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment testing of trade receivables is described in Note 2j.

i. Inventories

Inventories are stated at the lower of cost or net realisable value. Cost is determined using the moving average method, except for purchased products for which the first-in, first-out (FIFO) method is used.

The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs.
Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

j. Accounts Receivable – Trade

Trade receivables are carried at anticipated realisable value. A provision is made for impairment of receivables based on a periodic review of all outstanding amounts (Note 3a3)). Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is recognised in the income statement. During the year in which they are identified, bad debts are written off. The charge is reported within selling and marketing expenses of the consolidated income statement.

k. Cash Equivalents

Cash and cash equivalents includes all highly liquid investments, which include short-term bank deposits with original maturity of three months or less and bank overdrafts. Band overdrafts are shown within current liabilities on the balance sheet.

L. Share Capital:

1) Company shares held by subsidiary, which are purchased for the purpose of granting the shares to senior employees as part of an employee stock option plan approved by the Company's Board of Directors, are presented as reduction of "shareholders' equity" under "cost of Company shares held by subsidiary", at their cost to the subsidiary.

2) Incremental costs directly attributable to the issue of new shares or options are shown in shareholders' equity as a deduction, net of tax, from the proceeds.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

m. Deferred Income Taxes:

1) Deferred income taxes are computed using the liability method on temporary differences between the amounts presented in these statements and those taken into account for tax purposes. As for the main factors in respect of which deferred taxes have been included (Note 13e).

   Deferred tax balances are computed at the tax rate expected to be in effect at time of release to income from the deferred tax accounts. The amount of deferred taxes presented in the income statements reflects changes in the above balances during the year.

2) Taxes, which would apply in the event of disposal of investments in subsidiaries, have not been taken into account in computing the deferred taxes, as it is the Group's policy to hold these investments, not to realise them.

3) The Group may incur additional tax liability in the event of intercompany dividend distribution; no account was taken of the additional tax, since it is the Group's policy not to cause distribution of dividend, which would involve additional tax liability to the Company in the foreseeable future.

4) As stated in Note 13c, upon distribution of dividends from tax-exempt income of "approved enterprises", the amount distributed will be subject to tax at the rate that would have been applicable had Frutarom Ltd. not been exempted from payment thereof. The amount of the related tax is charged as an expense in the income statements, when such dividend is distributed.

   Frutarom Ltd. does not intend to distribute dividends out of tax-exempt income, as above.

n. Employee Benefits:

1) Pension Obligations.

   The Group operates a number of defined benefit and defined contribution plans throughout the world, the assets of which are generally held in insurance companies or severance pay funds, and are subject to periodic actuarial valuations.

   A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

   A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates that are denominated in the currency in which the benefits will be paid.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

As part of a restructuring plan in a German subsidiary, it was agreed with employees' work council to terminate the define benefit plan and to commence making deposits with a defined contribution plan for some of the employees. As to the effect of the said transition on the financial statements (Note 10c).

2) Share-Based Compensation.

The Group has share purchase plans approved by the Board of Directors (Note 14c), for granting shares and options to its employees. The Group effected early adoption of IFRS 2 (issued 2004) – share based payments to account for these plans. Set forth below is the accounting treatment applied, in accordance with the transition provisions of IFRS 2:

(a) Shares granted before 7 November 2002.
Prior to 7 November 2002, the Group only granted shares under the 1996 plan (Note 12c1)).

For these grants, the Group recognises compensation expenses in respect of the cash "outflow"; accordingly, the difference between the cost of the shares at date of purchase (Note 2L) and the exercise price the employee has to pay, is charged to income over the vesting period.

(b) Shares and options granted after 7 November 2002 and not vested at 1 January, 2004
The fair value of the employee services received in exchange for the grant of the shares and options granted after 7 November 2002 and not yet vested at 1 January 2004, is recognised as an expense. The compensation costs of each batch are spread over its vesting period. The total amount to be expensed over the vesting period is determined

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

by reference to the fair value of the shares and options granted. At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to shareholders' equity over the remaining vesting period.

The proceeds received, net of any directly attributable transaction costs, are credited to share capital (nominal value) and share premium when the rights to purchase shares are exercised.

3) Bonus Plans.

The Group recognises a liability and an expense for bonuses. The Group recognises a provision where it is contractually committed, or where there is a past practice that has created a constructive obligation.

o. Research and Product Development Costs

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success – considering its commercial and technological feasibility – and only if the cost can be measured reliably.

Generally, research and product development costs are charged against income as incurred since the criteria for their recognition as an asset are not set by management.

Participation from government departments for development of approved projects is recognised as a reduction of expense, as the related costs are incurred, in case that the Group estimates that it would not be required to refund such participation. In case that the Group estimates it would be required to refund government participation, the participation would be presented in the balance sheet among liabilities.

p. Provisions

Provisions for restructuring costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise termination of activities acquired and employee termination payments (Note 5b). Provisions are not recognised for future operating losses.
Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

q. Revenue Recognition Policy

Revenues from sales represent amounts received and receivable for goods supplied to customers after deducting volume discounts, turnover discounts and sales taxes. Sales are recognised when significant risks and rewards of ownership of the goods are transferred to the buyer, which is generally upon shipment of products to customers outside the Company.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

r. Earnings Per Share

Basic:
Basic earnings per share is calculated by dividing the profit attributed to equity holders of the Company using the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by subsidiary (Notes 2L).

The weighted average number of shares used in calculating Basic earnings per share is as follows:

Year end 31 December:	In thousands
2006	56,883
2005	55,671
2004	46,271

Fully diluted:
Diluted earnings per share is calculated adjusting average number of shares outstanding to assume conversion of all dilutive potential shares. A calculation is done, for that purpose, to determine the number of shares that could have been acquired at fair value (determined as average annual market share price of the Group's shares) based on the monetary value of the subscription rights attached to the outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued, assuming the exercise of the share options. The number of additional shares used in calculating earnings per share assuming conversion of share options is 905,608, 1,112,779 and 1,202,856 for 2006, 2005, and 2004, respectively.

s. Dividends

Dividend distribution to the Group's shareholders is recognised as a liability in the period in which the dividends are approved by the Group's Board of Directors.
Dividends declared subsequent to balance sheet date are given recognition in the note to these financial statements referring to subsequent events.

t. Reclassification

As part of the 2006 financial statements the company classified the cost of acquisition of ERP system to the intangible assets item rather than to property, plant and equipment. The comparative figures have been reclassified accordingly.

NOTE 3 – FINANCIAL RISK MANAGEMENT:

a. Financial Risk Factors

Financial risk management within the Group is governed by policies approved by the board of directors and senior management. These policies cover foreign exchange risk, interest rate risk, credit risk, price risk and liquidity risk. Group policies also cover areas such as cash management and raising short and long-term debt.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued):

The Group's business is characterised by considerable dispersion. Through its two divisions, the Group produces thousands of products intended for hundreds of customers throughout the world, using hundreds of raw materials purchased from a wide range of suppliers worldwide. As stated, the Group is not significantly dependent on any of its customers, products or suppliers.

Discussions on implementing the risk management policy as relates to currency exposure and interest are conducted by the Group's management once each quarter.

The Group does not use derivative financial instruments for its hedge or speculative purposes.

1) Market Risk.

(a) Foreign Exchange Risk.

1. General

The Group operates globally and is exposed to movements in foreign currencies affecting its net income and financial position, as expressed in U.S. dollars. Transaction exposure arises because the equivalent amount in local currency paid or received in transactions denominated in foreign currencies may vary due to changes in exchange rates. Most of the Group's subsidiaries generate their income primarily in the local currency. A significant amount of expenditures, especially for the purchase of goods for resale are in foreign currencies. Similarly, transaction exposure arises on net balances of monetary assets held in foreign currencies. The fact that raw materials purchases for the Group's production are also conducted in various currencies reduces currency exposure. The Group's subsidiaries manage this exposure locally. In addition, Group Treasury monitors total world-wide exposure with the help of comprehensive data received on a quarterly basis.

Generally, the Group does not take external hedging measures nor does it use derivative financial instruments for protecting itself from currency fluctuations.

Translation exposure arises from the consolidation of the Foreign Currency denominated financial statements of the Company's subsidiaries. The effect on the Company's consolidated shareholders' equity is shown as a currency translation difference

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued):

2. Linkage of Monetary Balances:

Foreign currency denominated monetary balances included in the Company's consolidated balance sheet at 31 December 2006, are summarised below:

	Dollars	NIS	Pound sterling	Euro	Swiss francs	Other currencies	Total
	U.S. dollars in thousands						
Assets:							
Current assets:							
Cash and cash equivalents	6,333	335	843	8,066	2,034	806	18,417
Short term investments				3,260			3,260
Accounts receivable:							
Trade	14,946	11,483	4,899	16,855	4,489	1,296	53,968
Other	1,554	1,549	1,014	4,026	1,532	363	10,038
	22,833	13,367	6,756	32,207	8,055	2,465	85,683
Liabilities:							
Current liabilities:							
Bank credit and loans				673			673
Accounts payable:							
Trade	4,322	5,493	2,609	9,419	5,601	56	27,500
Other	2,337	11,817	1,568	3,819	8,249	67	27,857
Provisions	946						946
Non-current liabilities:							
Retirement benefit obligations	669			5,925	905		7,499
Others				22,708			22,708
	8,274	17,310	4,177	42,544	14,755	123	87,183

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued):

(b) Raw Material Price Risks

Many of the raw materials used by the Group are natural products, which are seasonal. The Group purchases these for stock, generally during the season. Purchases are made out of season when necessary, sometimes at higher prices. The Group does not normally make future transactions. The Group is exposed to price changes in raw materials it uses in accordance with global price trends for these materials. The Group's Purchasing Department maintains an ongoing follow up on material prices. Selling prices of the Group's products are adjusted, as needed and as possible to significant and lengthy fluctuations in raw material prices.

2) Interest Rate Risk

Interest rate risk arises from movements in interest rates, which could have adverse effects on the Group's net income or financial position. Changes in interest rates cause variations in interest income and expenses on interest-bearing assets and liabilities.

3) Credit Risk

Credit risk arises from the possibility that the counter-party to a transaction may be unable or unwilling to meet their obligations causing a financial loss to the Company.

Trade receivables are subject to a policy of active risk management, which focuses on the assessment of country risk, credit limits, ongoing credit evaluation and accounting monitoring procedures.

Groups sales are made to a large number of customers in Europe, U.S.A., Israel, Asia, and other countries (Note 6b3)).

There are no significant concentrations within trade receivables of counter-party credit risk due to the large number of customers that the Group deals with and their wide geographical spread. Country risk limits and exposures are continuously monitored. Collateral is generally not required.

The provision for impairment of trade receivables is determined on basis of a periodic test of all amounts due.

The exposure of other financial assets and liabilities to credit risk is controlled by setting a policy for limiting credit exposure to high-quality counter-parties, continuously reviewing credit ratings, and limiting individual aggregate credit exposure accordingly.

4) Liquidity Risk.

The Company's subsidiaries must have sufficient availability of cash to meet their obligations. Individual companies are responsible for their own cash management, including the short-term investment of cash surpluses and the raising of loans to cover cash deficits, subject to Group policies and guidelines.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued):

b. Fair Value of Financial Instruments:

The fair value of the financial instruments included in working capital of the Company is usually identical or close to their carrying value. The fair value of long-term receivables and long-term loans and other long-term liabilities also approximates the carrying value, since they bear interest at rates close to the prevailing market rates.

The carrying amounts and fair values of the financial instruments are as follows:

	Carrying amounts			Fair values		
	31 December			31 December		
	2006	2005	2004	2006	2005	2004
	U.S. dollars in thousands			U.S. dollars in thousands		
Assets:						
Current assets:						
Accounts receivable:						
Trade	53,968	40,289	43,733	53,968	40,289	43,733
Other	10,038	6,756	7,291	10,038	6,756	7,291
Non-current assets:						
Long-term receivable			2,773			3,015
	64,006	47,045	53,797	64,006	47,045	54,039
Liabilities:						
Current liabilities:						
Bank credit and loans (net of current maturities)	673		44,750	673		44,750
Accounts payable:						
Trade	27,500	17,895	20,257	27,500	17,895	20,257
Other	27,997	22,162	20,718	27,997	22,162	20,705
Non-current liabilities:						
Loans and credit from banks (including current maturities)		289	35,436		289	35,436
Other*	22,708			22,227		
	78,878	40,346	121,161	78,397	40,346	121,148

* The fair values are based on cash flows discounted using a rate based on borrowings rate of 4.02%.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS:

The accounting estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS (continued):

a. Taxes on income and deferred taxes

The Group is assessed for tax purposes in a numerous jurisdictions; accordingly, group's management is required to exercise a high degree of judgment in order to determine the overall provision in respect of taxes on income. There are many transactions for which the ultimate tax determination is uncertain. The group records in its books of accounts. The group recognises liabilities for anticipated tax issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will be carried to income in the period in which the final tax assessment has been determined by the Tax Authorities.

The Group recognises deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. The group 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 group is unable to generate sufficient future taxable income in certain tax jurisdictions, 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 group 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.

b. Severance pay

The present value of Group 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 relating 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 the 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 sufficient to serve as basis for determining the rate of discount. Therefore, in determining this rate the group uses interest rate in the currency in which the benefits will be paid.

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

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS (continued):

c. Provision for contingent liabilities

Provision for legal contingent liabilities are recorded in the books of accounts in accordance with group management's judgment regarding the reasonability that the cash flows shall indeed by used to meet the liabilities, and on the basis of the estimate determined by the management regarding the present value of the expected cash outflows that would be required to meet the existing liabilities.

d. Provision for impairment in respect of goodwill and intangibles

The group tests once a year 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 group. The recoverable amount of a cash-generating unit is determined in accordance with the assumptions and calculations made by management.

e. As for Accounts receivable trade and others, see note 2j and 3a3).

NOTE 5 – BUSINESS COMBINATIONS:

a. Acquisition of Flachsmann in 2003

In 2003, the Group completed the purchase of full ownership in Flachsmann, in consideration for Swiss Francs 23,068 thousands ($ 17,773 thousands).
Swiss Francs 20,068 thousands ($ 15,462 thousands) out of the said amount were paid in cash on date of acquisition; Swiss Francs 1.5 million ($ 1,262 thousands) was paid in June 2004 and an additional amount of Swiss Francs 1.5 million ($ 1,170 thousands) was paid in June 2005.

As a result of the acquisition, commencing 30 June 2003, the assets and liabilities of Flachsmann were consolidated for the first time. The consolidated statement of income includes the results of operations of Flachsmann, commencing the said date.

Flachsmann is engaged in developing, manufacturing and marketing flavors and extracts for the food industry as well as herbal extracts for the extracts, flavors and pharmaceutical industries and applications for the food industry.

As part of the said acquisition, the Group has established a plan for the reorganisation of the activities of Flachsmann. This reorganisation plan was designed to reduce costs, merge the marketing activities and utilize the synergy between the Company's and Flachsmann's activities. The plan included the merger of Flachsmann's activities in Canada and Europe with the Company's existing activities, while reducing the number of Flachsmann's employees and also included termination of activities of sites held by Flachsmann (Note 21).

Total cost of the acquisition of Flachsmann has created for the Company negative goodwill at the total amount of $ 7,599 thousands.

In 2004, the Group changed the provision for reorganisation, since it managed to reduce reorganisation costs, as against an increase of $ 220 thousands in negative goodwill; (the said amount is net of the related tax of $ 23 thousands).

NOTE 5 – BUSINESS COMBINATIONS (continued):

The amount of negative goodwill was carried to income, commencing the date of acquisition, on a systematic basis, over the remaining weighted average useful life of the identified acquired depreciable assets. On 1 January 2005, in accordance with the transition provisions of IFRS 3, the Company de-recognised the balance of remaining negative goodwill, which has not yet been carried to income – amounting to $ 7,731 thousands (net of deferred taxes de-recognised amounting to $ 1,785 thousands) (Notes 2f and 7).

b. Acquisition of European FS from IFF

In 2004, the Company completed the acquisition of the FS of IFF in Europe (Note 1c1).

IFF's FS business includes the development and production of unique fruit compounds and other natural products used as natural flavors in the production of a wide variety of food products, such as dairy products, pastries, etc. The FS operations of IFF were carried out in three independent plants, located in Switzerland, Germany and France.

In accordance with the letter of intent, signed between the parties in May 2004, the transaction included the entire European FS operations, except that all of the French employees will be excluded, as it was Group's explicit intention to transfer the French production activity to the German and Swiss production sites. This required IFF to enter into a consultation process with the employees' work council in France, in order for the Group to be able to transfer the French FS operations to Germany and Switzerland and to enable IFF to sell the French FS business to the Group. As a result, and after agreeing on the principal acquisition terms, the parties agreed to proceed with the acquisition of the Swiss and German operations and withhold the process of the French operations acquisition, until IFF completes the consultation process in accordance with the French law.

As detailed below, the acquisition of the German and Swiss operations was completed on 17 August 2004, and the acquisition of the French operations was completed on 29 October 2004.

1) Acquisition of the German and Swiss Operations:

(a) On 17 August 2004, the Group completed the acquisition of the Swiss and German FS operations. According to the purchase agreement, the Group has purchased, through its subsidiaries, the fixed assets, intellectual property, inventory and prepaid expenses of the said plants, in consideration for approximately € 30 million ($ 37 million). The employees of the purchased activity have been transferred to the subsidiaries, and so were the assets and liabilities related to the employees and to their retirement rights, which were evaluated at date of signing the agreement as net liabilities in the amount of approximately € 2.5 million ($ 3.1 million). Accordingly, on 18 August 2004, the Group paid IFF an amount of approximately € 27.5 million ($ 33.9 million).

As of 31 December 2004, the net cost of acquisition of the German and Swiss operations (net of liabilities related to the employees and to their retirement rights, which have been transferred to the subsidiaries) amounted to € 25.8 million ($ 31.8 million). This cost includes purchase expenses in the total amount of € 0.4 million ($ 0.5 million), and is net of adjustments related to the purchase, at the total amount of € 2.2 million ($ 2.6 million).

NOTE 5 – BUSINESS COMBINATIONS (continued):

The original 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 and the remaining balance in the amount of $ 2.2 million was allocated to goodwill. The intangible assets recognised included product formulas, customer relationships and goodwill.

(b) On 5 September 2005, the Group and IFF agreed on certain adjustments, under the purchase agreement of the German and Swiss operations amounting to € 2.9 million ($ 3.5 million). The adjustments made to the fair value of the fixed assets, inventory, assets and liabilities related to the employees and to their retirement rights at the date of acquisition, decrease the cost of acquisition by the said amount. $ 2.6 million of the above, have already been taken into account in the purchase accounting in 2004 (see (a) above).

As a result of the abovementioned adjustment, the Group reduced the goodwill arising from the purchase of the operations by € 0.7 million ($ 0.9 million). According to the said agreement, the Group received from IFF, during September 2005, an amount of € 2 million ($ 2.5 million) in cash. The remaining balance was set off against the Company's debt to IFF, in accordance with the agreement.

(c) 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 € 1.75 million.
As a result of the abovementioned adjustment ($ 2.1 million), the Compnay reduced the goodwill arising from the purchase of the operations by € 1.1 ($ 1.3 million) and a negative goodwill in the amount of € 0.65 ($ 0.8 million) was created for the Company. The amount of negative goodwill was carried directly to income.

In accordance with the earn-out mechanism mentioned above, the purchase price of the Swiss and German operations was to be reduced as of 31 December, 2006 was reduced by approximately an additional € 1.75 million ($ 2.2 million). The said amount represents negative goodwill and is carried directly to income; (presented among other income).

(d) In conjunction with the purchase agreement, another agreement was signed that enables the Group to continue manufacturing certain supplementary products to the customers of the purchased operations, in consideration for 50% of the gross profit arising from the sale of those products for a 5-year period commencing at date of purchase. The annual expense arising in respect of this commitment is not material.

(e) The acquisition of the operations as above was financed by short-term bank loans at the total amount of $ 34 million, which were repaid in February 2005.

NOTE 5 – BUSINESS COMBINATIONS (continued):

2) Acquisition of the Operation in France:

(a) On 29 October 2004, the Group completed the purchase of the French FS operations. As initially agreed in the letters of intent, the French operations were purchased for a consideration of approximately € 3.5 million ($ 4.3 million) subject to certain adjustments, including the earn-out adjustment mechanism that was set in the agreement for the purchase of the German and Swiss operations (see (a) above).

The said purchase concerns the assets of the operations in France (including intangible assets) and does not include transfer of employees. Through the end of 2004, the Group has relocated the manufacturing activities to Germany and Switzerland for the purpose of reducing costs and utilising the synergy between the purchased operations and the Group's activities.

The research and development operations, the marketing and selling operations, which serve the French market, will continue to operate in France.

In November 2004, the Group paid IFF € 3 million ($ 3.8 million) after the parties agreed to adjust the purchase price by an amount of € 0.5 million ($ 0.6 million), due to adjustments made to the fair value of the fixed assets and inventory at the date of acquisition.

The cost of purchase was allocated mainly to acquired tangible and intangible assets, based on their fair value at date of acquisition.

(b) In accordance with the agreement signed in September between the Group and IFF (see also 1b above), the cost of acquisition of the French operations was reduced by € 1.1 million ($ 1.4 million). As a result of the abovementioned adjustment, the Group increased the negative goodwill arising from the purchase of the French operations by € 0.6 million ($ 0.7 million). The increase in negative goodwill was carried directly to income.

(c) The acquisition of the operations as above was financed by short-term bank loan (granted in Euro) at the total amount of $ 3.8 million. The loan was repaid in February 2005.

3) The results of the purchased of the German and Swiss operations and the France operations for the periods starting 17 August and 2 November 2004 (dates of purchase of operations), respectively, through 31 December 2004 were included for the first time in the consolidated financial statements for the year ended 31 December 2004.

NOTE 5 – BUSINESS COMBINATIONS (continued):

Set forth below are the of the purchased operations that were included in consolidation in 2004:

The acquired operations contributed revenues of $ 20,641 thousands, and net income of $ 892 thousands to the Group for the period from 17 August (as to German and Swiss operations), 2004, and 2 November 2004 (as to the to French operations) to 31 December 2004. Had the acquisition of the German, Swiss and French operations occurred on 1 January 2004, Group's revenue for 2004 would have been $ 252,678 thousands, and net profit for that year would have been $ 19,384 thousands.

Assets and liabilities of the purchased German, Swiss and France operations, at the date of acquisition:

	***Fair value**	**Acquiree's carrying amount**
	U.S. dollars in thousands	
Cash and cash equivalents	9	9
Inventories	7,457	9,007
Receivables	337	486
Property, plant and equipment – net	29,161	14,575
Goodwill	2,214	
Negative Goodwill (carried directly to income)	(199)	
Intangible assets	3,136	
Deferred tax assets	1,082	
Current liabilities	(1,946)	(1,624)
Retirement benefit obligations - pensions	(5,899)	(3,326)
Deferred tax liabilities	(274)	
	35,078	19,127

* Prior to the adjustments to the purchase price, see (1) and (2) above.

The amount of $ 38.2 million, presented in the cash flow statements, includes the amounts receivable from IFF, as above, and does not include accrued and not yet paid purchase expenses.

c. Acquisition of Nesse in 2006

On 17 January, 2006, the Group acquired, 70% of the shares that confer ownership and control in GewürzMühle Nesse GmbH and in GewürzMühle Nesse Gebr. Krause GmbH (hereafter together - 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 Group paid, at date of acquisition, a total in cash of € 18.41 million ($ 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).

NOTE 5 – BUSINESS COMBINATIONS (continued):

The Group 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 Group; 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 Group 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 under long-term liabilies.

The total cost of purchase, included in these financial statements, in the amount of € 35,683 thousands ($ 43,123 thousands), comprises of the present value of the liabilities, based on Group'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 € 4,079 thousands ($ 4,929 thousands) and € 12,730 thousands ($ 15,384 thousands), respectively; and of purchase expenses in the total amount of € 463 thousands ($ 559 thousands).
The increase in the present value of the liability in respect of the period of time that elapsed is recognised as interest expenses.

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 Group updates its projections every cut-off date. 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 € 5,433 thousands ($ 6,566 thousands), customer relations in the amount of € 2,283 thousands ($ 2,759 thousands) and goodwill in the amount of € 17,508 thousands ($ 21,158 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. In accordance with the said purchase agreement, the group updated the cost of acquisition; as a result, the amount of goodwill increased by € 1.9 million ($ 2.3 million).

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.

NOTE 5 – BUSINESS COMBINATIONS (continued):

Set forth below are Nesse's data included in the consolidated financial statements as of 31 December 2006:

	31 December 2006
	U.S. dollars in thousands
Balance sheet:	
Current assets:	
Cash and cash equivalents	2,587
Short-term investments*	3,228
Accounts receivable:	
Trade	4,802
Other	998
Inventories	4,358
Long-term loans	3,329
Deferred income tax assets	186
Fixed assets – net	5,663
Intangible assets (including goodwill)	35,028
Current liabilities:	
Bank credit and loans	(673)
Accounts payable:	
Trade	(1,778)
Other	(637)
Non-current liabilities:	
Retirement benefit obligations	(171)
Deferred income tax liabilities	(3,953)
Other liabilities**	(22,708)
	30,259

* 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 € 13.1 million ($ 17.2 million) and the liability for the success fee payment at the amount of € 4.2 million ($ 5.5 million). The liabilities are presented at present value; annual capitalization rate – 2.86%.

NOTE 5 – BUSINESS COMBINATIONS (continued):

The acquired operations contributed revenues of $ 36,752 thousands, and net income of $ 4,761 thousands to the Company for the period from 1 January 2006 to 31 December 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
Deferred tax assets	413	63
Property, plant and equipment – net	5,706	5,706
Goodwill*	21,158	
Intangible assets	9,325	
Bank credit and loans	(742)	(742)
Accounts payable:		
Trade	(1,949)	(1,949)
Other	(3,420)	(3,414)
Retirement benefit obligations – pensions	(156)	(156)
Deferred tax liabilities	(4,009)	(278)
	41,047	14,823

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

The amount of $ 21,014 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 and not yet paid purchase expenses.

d. Acquisition of Acatris in 2006

On October 1, 2006, the Group acquired, 100% of the issued and paid share capital of the U.S. company Acatris Inc., of the Dutch company, Acatris Specialities Holdings B.V., and of the Belgian company, Acatris Belgium N.V. (hereafter together – Acatris).
Acatris has multinational operations centered in the Netherlands and Belgium and is a member of the Dutch Royal Schouten Group N.V. Acatris develops, manufactures and markets innovative and unique botanical ingredients; Acatris Health's LifeLine product range includes Linumlife, Fenulife, and Soylife, which are strong reputable product brands and enjoy both licenses and patents that effectively promote and protect the sales of these clinically-proven natural health ingredients. Actaris' extensive customers' base includes hundreds of leading companies in the food supplement, functional food, natraceuticals and cosmetics markets, largely in Western Europe and the U.S.A.

NOTE 5 – BUSINESS COMBINATIONS (continued):

At date of acquisition, the company paid a cash amount of € 10.5 million ($ 13.3 million) as consideration for the acquisition.

The cost of the acquisition is to be allocated to acquired tangible and intangible assets (including goodwill) and to liabilities based on their fair value at date of acquisition.

The intangible assets recognized include: product formulas in the amount of € 1,108 thousands ($ 1,405 thousands), customer relations in the amount of € 353 thousands ($ 448 thousands) and goodwill in the amount of € 5,087 thousands ($ 6,451 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.

Set forth below are Acatris' data included in the consolidated financial statements as of 31 December 2006:

	31 December 2006
	U.S. dollars in thousands
Balance sheet:	
Current assets:	
Cash and cash equivalents	1,088
Accounts receivable:	
Trade	2,875
Other	831
Inventories	3,746
Deferred income tax assets	90
Fixed assets – net	2,713
Current liabilities:	8,602
Accounts payable:	
Trade	(2,313)
Other	(1,245)
Non-current liabilities - deferred income taxes	(1,072)
	15,315

The acquired companies contributed revenues of $ 3,400 thousands, and net income of $ 188 thousands to the Company for the period from 1 October 2006 to 31 December 2006. Had the acquisition of Acatris occurred on 1 January 2006, Group's renewal for 2006 would have been $ 300,530.

NOTE 5 – BUSINESS COMBINATIONS (continued):

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

	Fair value	Acquiree's Carrying Amount
	U.S. dollars in thousands	
Cash and cash equivalents	46	46
Receivables:		
Trade	2,630	2,694
Other	461	461
Inventories	3,133	3,265
Deferred tax assets	67	
Property, plant and equipment – net	2,660	2,146
Goodwill	6,451	
Intangible assets	1,853	
Accounts payable:		
Trade	(1,499)	(1,499)
Other	(1,202)	(1,202)
Deferred tax liabilities	(1,025)	(211)
	13,575	5,700

The amount of $ 13,376 thousands, presented in the cash flow statements, does not include accrued and not yet paid purchase expenses.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – SEGMENT INFORMATION:

a. Business Segment Data:

As at 31 December 2006, and for the year then ended:

	Flavors division	Fine ingredients division	Trade and marketing division	Eliminations	Consolidated
Income statement data:	U.S. dollars in thousands				
Sales and other operating income – net:					
Unaffiliated customers	187,030	93,468	6,749		287,247
Intersegment		4,896		(4,896)	
Total sales and other operating income	187,030	98,364	6,749	(4,896)	287,247
Segment results	30,078	7,056	200		37,334
Unallocated corporate expenses					(279)
Operating profit	29,848	7,286			37,055
Financial expenses					445
Taxes on income					6,908
Net income					29,702
Other data:					
Segment assets	130,726	49,595	2,021		182,342
Unallocated corporate assets					134,355
Consolidated total assets					316,697
Segment liabilities	56,436	7,768	868		65,072
Unallocated corporate liabilities					34,492
Consolidated total liabilities					99,564
Cost of purchase of long-term assets – CAPEX	1,937	3,794			
Depreciation and amortisation	3,147	1,264			

NOTE 6 – SEGMENT INFORMATION (continued):

a. **Business Segment Data** (continued):

As at 31 December 2005, and for the year then ended:

	Flavors division	Fine ingredients division	Trade and marketing division	Eliminations	Consolidated
	U.S. dollars in thousands				
Income statement data:					
Sales and other operating income – net:					
Unaffiliated customers	*150,437	*87,040	6,326		243,803
Intersegment		2,728		*(2,728)	
Total sales and other operating income	*150,437	*89,768	6,326	(2,728)	243,803
Segment results	*24,269	*9,460	238		33,967
Unallocated corporate expenses					(229)
Operating profit					33,738
Financial expense					(416)
Taxes on income					(6,475)
Net income					26,847
Other data:					
Segment assets	93,558	44,507	2,721		140,786
Unallocated corporate assets					93,080
Consolidated total assets					233,866
Segment liabilities	21,477	8,787	1,077		31,341
Unallocated corporate liabilities					24,717
Consolidated total liabilities					56,058
Cost of purchase of long-term assets – CAPEX	4,258	4,885			
Depreciation and amortisation	3,776	1,918			

* Reclassified.

NOTE 6 – SEGMENT INFORMATION (continued):

a. **Business Segment Data** (continued):

As at 31 December 2004, and for the year then ended:

	Flavors division	Fine ingredients division	Trade and marketing division	Eliminations	Consolidated
Income statement data:	U.S. dollars in thousands				
Sales and other operating income – net					
Unaffiliated customers	110,908	79,120	6,752		196,780
Intersegment		2,612		(2,612)	
Total sales and other operating income	110,908	81,732	6,752	(2,612)	196,780
Segment results	15,352	6,512	256		22,120
Unallocated corporate expenses					(108)
Operating profit					22,012
Financial expense					(1,347)
Taxes on income					(4,909)
Net income					15,756
Other data:					
Segment assets	105,291	51,170	2,777		159,238
Unallocated corporate assets					54,502
Consolidated total assets					213,740
Segment liabilities	17,199	7,959	1,076		26,234
Unallocated corporate liabilities					108,853
Consolidated total liabilities					135,087
Cost of purchase of long-term assets – CAPEX	1,689	2,179			
Depreciation and amortisation	2,588	2,152			

NOTE 6 – SEGMENT INFORMATION (continued)**:**

b. Information on Business and Geographical Segments:

1) Business Segments.

For management purposes, the Group is organised on a worldwide basis into two major operating activities: the Flavor Division and the Fine Ingredients Division. Another operating activity is the Trade and Marketing, which is incorporated as a separate company in Israel (each division is considered to be a business segment (Note 2d).

The Flavor Division is engaged in the development, manufacturing, marketing and sale of flavors, compounds and food systems. The Fine Ingredients Division is engaged in the development, manufacturing, marketing and sale of natural flavors extracts, natural functional food ingredients, natural pharma-nutraceutical extracts, specialty essential oils and citrus products, aroma chemicals and natural gums.

The Trade and Marketing activity focuses in trade and marketing of raw materials produced by third parties to customers in Israel. The divisions are the basis on which the Company reports its primary segment information.

2) Geographical Segments.

The Group has operating production facilities in Europe, North America, Israel and Asia. In addition, the Group has 22 research and development laboratories and sells and markets its products principally through its 45 sales and marketing offices.

The trade and marketing operations of raw materials are carried out in Israel by a subsidiary of the Company, which imports products not produced by Frutarom Ltd.

3) Sales by Destination Based on Customer Location

Following are data regarding the distribution of the Company's consolidated sales by geographical market, based on customer locations:

	Year ended 31 December		
	2006	**2005**	**2004**
	U.S. dollars in thousands		
Israel	33,112	30,983	27,269
North America	34,451	30,285	30,337
Europe	174,572	143,259	102,247
Asia and the Far East	25,402	24,784	24,408
Other countries	19,710	14,492	12,519
	287,247	243,803	196,780

NOTE 6 – SEGMENT INFORMATION (continued):

4) Assets and Additions to Property, Plant, Equipment, and Intangible Assets by Geographical Area

Following are data reflecting the carrying value of segment assets and additions to property, plant, equipment, and intangible assets by geographical area in which the assets are located:

	Carrying value of segment assets			Additions to property, plant equipment, and intangible assets		
	31 December			Year ended 31 December		
	2006	2005	2004	2006	2005	2004
	U.S. dollars in thousands					
Israel	82,157	88,068	64,492	2,412	**2,520	2,161
North America	16,620	16,382	16,611	3,720	**2,986	421
Europe	216,063	126,013	129,979	*7,693	7,721	***37,577
Other countries	1,857	3,403	2,658	51	253	113
	316,697	233,866	213,740	13,876	13,480	40,272

* Including Nesse and Acatris, see note 5c and 5d.
** Including assets acquired from other segments.
*** Including IFF segment (Note 5b).

5) Segment Assets and Liabilities.

Segment assets include all operating assets used by a segment and consist principally of receivables, inventories, property, plant and equipment and intangible assets, net of impairments and provisions. While most such assets can be directly attributed to individual segments, the carrying value of certain assets used jointly by two or more segments is allocated to the segments on a reasonable basis. Segment liabilities include all operating liabilities and consist principally of trade payables, wages, and taxes currently payable and accrued liabilities (including severance pay).

6) Inter-Segment Transfers.

Segment revenue, segment expenses and segment results include transfers between business segments and between geographical segments. Such transfers are accounted for at normal terms and conditions charged to unaffiliated customers for similar goods. Such transfers are eliminated in consolidation.

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT:

a. Composition of Assets, Grouped by Major Classifications, and Changes Therein is as Follows:

2006:

	Cost					Accumulated depreciation					Depreciated balance
	Balance at beginning of year	Additions during the year	Retirements during the year	Other*	Balance at end of year	Balance at beginning of year	Additions during the year	Retirements during the year	Other*	Balance at end of year	31 December 2006
	U.S. dollars in thousands					U.S. dollars in thousands					
Land and buildings	48,607	2,494	(262)	3,285	54,124	4,739	1,200	(69)	207	6,077	48,047
Machinery and equipment	61,324	6,598	(485)	11,943	79,380	25,806	6,347	(309)	1,150	32,994	46,386
Vehicles and forklifts	2,452	602	(35)	64	3,083	979	143	(10)	15	1,127	1,956
Furniture and office equipment (including computers)	9,664	45	(72)	501	10,138	6,195	698	(63)	277	7,107	3,031
Leasehold improvements	3,108	317	-,-	209	3,634	1,328	-,-	-,-	71	1,399	2,235
	125,155	10,056	(854)	16,002	150,359	39,047	8,388	(451)	1,720	48,704	101,655

* Arising from differences from acquisition of subsidiaries and from translation of foreign currency financial statements of subsidiaries.

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT (continued):

a. Composition of Assets, Grouped by Major Classifications, and Changes Therein is as Follows:

2005:

	Cost					**Accumulated depreciation**					**Depreciated balance**
	Balance at beginning of year	**Additions during the year**	**Retirements during the year**	**Other***	**Balance at end of year**	**Balance at beginning of year**	**Additions during the year**	**Retirements during the year**	**Other***	**Balance at end of year**	**31 December 2005**
	U.S. dollars in thousands					**U.S. dollars in thousands**					
Land and buildings	57,021	1,234	4,279	(5,369)	48,607	3,384	1,324		31	4,739	43,868
Machinery and equipment	58,784	6,248	151	(3,557)	61,324	21,734	4,886	113	(701)	25,806	35,518
Vehicles and forklifts	2,285	468	235	(66)	2,452	859	302	174	(8)	979	1,473
Furniture and office equipment (including computers)	8,274	2,082	153	(539)	9,664	5,659	890	108	(246)	6,195	3,469
Leasehold improvements	3,204	68		(164)	3,108	1,249	133		(54)	1,328	1,780
	129,568	10,100	4,818	(9,695)	125,155	32,885	7,535	395	(978)	39,047	86,108

* Arising from differences from translation of foreign currency financial statements of subsidiaries

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT (continued):

a. Composition of Assets, Grouped by Major Classifications, and Changes Therein is as Follows:

2004:

	Cost						Accumulated depreciation					Depreciated balance
	Balance at beginning of year	Additions during the year	Retirements during the year	Acquisition of the FS from IFF (see Note 5b)	Other*	Balance at end of year	Balance at beginning of year	Additions during the year	Retirements during the year	Other*	Balance at end of year	31 December 2004
	U.S. dollars in thousands						U.S. dollars in thousands					
Land and buildings	36,680	1,080		15,545	3,716	57,021	2,574	784		26	3,384	53,637
Machinery and equipment	40,742	3,296	(270)	12,583	2,433	58,784	16,781	4,524	(126)	555	21,734	37,050
Vehicles and forklifts	1,828	778	(454)	98	35	2,285	928	210	(281)	2	859	1,426
Furniture and office equipment (including computers)	6,341	747	(39)	935	290	8,274	4,618	942	(34)	133	5,659	2,615
Leasehold improvements	3,037	59			108	3,204	1,069	151		29	1,249	1,955
	88,628	5,960	(763)	29,161	6,582	129,568	25,970	6,611	(441)	745	32,885	96,683

* Arising from differences from translation of foreign currency financial statements of subsidiaries and from adjustment to purchase price of Flachsmann (Note 5a).

NOTE 7 - PROPERTY, PLANT AND EQUIPMENT (continued):

b. Rights in Land:

1) The land on which the plants of an Israeli subsidiary, a U.S. subsidiary, a Swiss subsidiary, a German subsidiary, a U.K. subsidiary and a Belgian subsidiary are located is under the ownership of the Group.
2) Through 31 December 2006, the Group paid an amount of $ 1,289 thousands in respect of development of the land located in the industrial zone in the north of Israel. As to capitalized lease fees paid in respect of the land (Note 17a2).

c. The Group plans to expand its Haifa bay plant through a total investment of approximately $ 2.5 million, as part of a plan approved by the Israeli Investment Centre, in accordance with the Law for Encouragement of Capital Investments, 1959 (Note 13c).
The Company has another plan for expansion of its plant, at a total investment of $ 2.5 million, under the amendment to the Law for the Encouragement of Capital Investments, as published in April 2005 (Note 13c). Through 31 December 2006, the Group completed its investments under the said expansion plans.

d. A subsidiary has a plan for the erection of a new plant in the industrial zone in the north of Israel, at a total investment of up to $ 18 million. The Investment Centre has approved this plan as part of the expansion of existing Company plants, in accordance with the Law for Encouragement of Capital Investments, 1959 (Note 13c). Implementation of investment is to be partly financed by investment grants of up to $ 4 million.

e. In 2001, the Group decided to change its original plan of use and postpone the date of operating of certain assets, in the amount of approximately $ 1,662 thousands, which have been acquired in 2000; accordingly, the Group reassessed the recoverability of the assets and recognised impairment losses in the amount of $ 448 thousands, $92 thousands and $ 97 thousands in 2001, 2002 and 2004, respectively, in respect of the said assets, computed on the basis of net selling price of the assets, which was determined by reference to an active market. Running in the said assets and installation thereof commenced in 2006. The assets were first activated in at the beginning of 2007.

f. As to pledges on assets –Note 14.

NOTE 8 – INTANGIBLE ASSETS :

	Original amount			**Amortised balance**		
	31 December			**31 December**		
	2006	**2005**	**2004**	**2006**	**2005**	**2004**
	U.S. dollars in thousands					
Product formulas	19,299	9,800	10,415	15,601	7,210	8,210
Goodwill	35,544	3,091	5,719	34,141	1,786	4,332
Negative goodwill			(11,105)			(9,516)
Customer relations	5,394	1,884	2,184	4,603	1,618	2,096
Trademarks	279	245	274	202	190	226
ERP system	5,844	1,797		5,625	1,797	
	66,360	16,817	7,487	60,172	12,601	5,348

NOTE 8 – INTANGIBLE ASSETS (continued):

	ERP system	Product formulas	*Goodwill	Negative goodwill	Customer relations	Trademarks	Total
			U.S. dollars in thousands				
Opening net book amount		7,156	1,955	(9,465)		223	(131)
Adjustment to purchase price of Flachsmann (Note 5a)				(243)			(243)
Changes in year ended 31 December 2004:							
Acquisition of the FS business from IFF (Note 5b)		1,152	2,214		1,984		5,350
Exchange differences		481	371	(777)	195	16	286
Amortisation charge (Note 2f)		(579)	(208)	969	(83)	(13)	86
Closing net book amount	-,-	8,210	4,332	(9,516)	2,096	226	5,348
De-recognition of the balance of recognised negative goodwill (Note 2f)				9,516			9,516
Changes in year ended 31 December 2005:							
Adjustment to purchase price of IFF's FS business (Note 5b)			(2,271)				(2,271)
Additions	1,901	229	103				2,233
Exchange differences	(104)	(689)	(378)		(278)	(23)	(1,472)
Amortisation charge (Note 2f)		(540)			(200)	(13)	(753)
Closing net book amount	1,797	7,210	1,786	-,-	1,618	190	12,601
Changes in year ended 31 December 2006:							
Additions	3,820						3,820
Adjustments arising from acquisition of subsidiaries		7,971	27,609		3,207		38,787
Changes in amount of excess of cost of acquisition (Note 5c)			2,267				2,267
Impairment					(126)		(126)
Exchange differences	223	1,296	2,479		387	25	4,410
Amortisation charge (Note 2f)	(215)	(876)			(483)	(13)	(1,587)
Closing net book amount	5,625	15,601	34,141	-,-	4,603	202	60,172

* Goodwill as of December 31, 2006is allocated to the Flavor segment in the U.K. and in Germany and to the Fine Ingredients segment in Belgium.

NOTE 9 – LONG-TERM LOANS AND CREDIT FROM BANKS:

a. The long-term loans and credit may be classified by currency of repayment, linkage terms and interest rates, as follows:

	31 December	
	2005	**2004**
	U.S. dollars in thousands	
Revolving credit facilities(1):		
U.S. dollar		14,181
Swiss Francs(2)	289	13,500
Loans:		
U.S. dollar		2,067
Pound sterling		5,688
	289	35,436
Less – current maturities	(289)	5,605
	-,-	29,831

(1) Including agreements with banks whereunder the banks will extend Israeli, U.S., U.K., and Swiss subsidiaries revolving credit facilities. As of 31 December 2006, the unutilized credit balances of Israeli subsidiaries, $ 3.2 millions.

(2) The balance was repaid in January 2006.

b. During 2005, the Group used the consideration it received in respect of the issuance of shares (Note 12b), to repay all the long-term bank loans and credit from banks.

NOTE 10 – RETIREMENT BENEFIT OBLIGATIONS:

a. Labour laws and agreements in Israel and abroad require the subsidiaries of the Company to pay severance pay and/or pensions to employees dismissed or retiring from their employ in certain other circumstances. The Israeli companies' liability is covered mainly by regular contributions in defined contribution plans. The amounts funded as above are not reflected in the balance sheets since they are not under the control and management of the companies.

b. Under the agreement with its employees, the U.S. subsidiary financed a defined benefit plan. As part of the collective agreement signed between the Company's subsidiary and the industrial labour union on 13 October, 2000, the U.S. subsidiary suspended the said plan and joined, as from that date, a comprehensive pension plan of the labour union, which is a defined contribution plan.

The U.S. subsidiary will continue financing its existing liabilities under the suspended pension plan. The amount of liability for employee rights upon retirement and amounts funded, as presented in the consolidated accounts, reflect the U.S. subsidiary's liability in respect of the suspended plan.

c. The Swiss and German subsidiaries have a liability for payment of pension to employees in Switzerland and Germany under a defined benefit plan. The said liabilities have

NOTE 10 - RETIREMENT BENEFIT OBLIGATIONS (continued):

been transferred to these subsidiaries as part of the Flachsmann, FS and Nesse acquisitions in 2003, 2004 and 2006, respectively (Note 5). The Swiss and German subsidiaries make deposits with pension plans in respect of these liabilities. The amount of the liability for pension (net) included in the balance sheet reflects the difference between the two following components, computed as follows:

1) The liability for pension payment is computed on the basis of the balance of the liability at date of acquisition of Flachsmann, the FS and Nesse, with the addition of service expenses and interest expenses (computed in accordance with rate of capitalisation as of balance sheet date) and net of the amounts paid in the period in respect of pension.

2) The assets of the pension fund are computed based on the balance of the assets at date of acquisition of Flachsmann, the FS and Nesse, with the addition of the expected yield on the fund's assets and the deposits made with the pension fund in the period, net of the amounts paid in the period in respect of pension.

As part of a restructuring plan in a German subsidiary, it was agreed with employees' work council to terminate the define benefit plan and to commence making deposits with a defined contribution plan for some of the employees. As a result of the said transition, the retirement benefit obligations of was decreased by € 900 thousands ($ 1.1 million), after the tax effect of € 540 thousands ($ 680 thousands). The said amount was carried to income as a reduction of payroll costs. The company has concurrently carried to income payroll costs related to this plan, in the total amount of € 379 thousands ($ 479 thousands), after the tax effect of € 222 thousands ($ 287 thousands).

d. The following amounts related to employee remuneration and benefits are included in determining operating profit:

	2006	2005	2004
	U.S. dollars in thousands		
Wages and salaries	51,928	46,632	36,182
Social security costs	8,140	5,285	5,300
Post-employment benefits: defined benefit plans	(275)	1,192	1,560
Post-employment benefits: defined contribution plans	1,023	1,551	517
Termination benefit expenses	520	168	173
Compensation under stock option plans and other employee benefits	1,538	2,749	4,086
Total employees' benefits	62,874	57,577	47,818

At year-end, the Group employed 1,154 people (1,016 and 977 people, respectively, in 2005 and 2004).

NOTE 10 - RETIREMENT BENEFIT OBLIGATIONS (continued):

Amounts recognised in the income statement for post-employment defined benefit plans consist of the following:

	2006	2005	2004
	U.S. dollars in thousands		
Current service cost	1,637	1,736	1,492
Interest cost	1,502	1,709	1,041
Actual return on plan assets – U.S. and German subsidiaries	(291)	(171)	(185)
Expected return on plan assets – Swiss and German subsidiaries	(1,253)	(1,253)	(774)
Employees' contributions	(893)	(856)	(280)
Net actuarial losses (gains) recognised	(977)	27	266
Total included in employees' remuneration	(275)	1,192	1,560

Changes during the year in the net asset (liability) recognised in the balance sheet for post-employment defined benefit plans were as follows:

	2006	2005	2004
	U.S. dollars in thousands		
At 1 January	7,775	8,502	1,232
Increase as a result of acquisition for the first time of a subsidiary	155		5,899
Total expenses (revenues) included in employees' remuneration	(275)	1,192	1,560
Contributions paid	(932)	(899)	(900)
Currency translation effects and others	776	(1,020)	711
At 31 December	7,499	7,775	8,502

The following amounts were recognised in the balance sheet for post-employment defined benefit plans:

	31 December		
	2006	2005	2004
	U.S. dollars in thousands		
Actuarial present value of funded obligations due to former employees and present employees	47,997	39,712	45,062
Plan assets held in trusts at fair value	(39,541)	(33,071)	(36,733)
Plan assets under actuarial present value of funded obligations	8,456	6,641	8,329
Unrecognised actuarial losses (gains)	(957)	1,134	173
Recognised liability for funded obligations due to past and present employees	7,499	7,775	8,502

Amounts recognised in the balance sheet for post-employment defined benefit plans are predominantly non-current and are reported as non-current assets and non-current liabilities.

NOTE 10 - RETIREMENT BENEFIT OBLIGATIONS (continued):

The Group operates defined benefit schemes in several countries for which the actuarial assumptions vary based on local economic and social conditions. The assumptions used in the actuarial valuations of the defined benefit plans, were as follows:

	U.S.A.			Germany			Switzerland		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Discount rates	5.75%	5.75%	5.75%	4.50%	4.00%	4.75%	2.90%	3.00%	3.75%
Projected rates of remuneration growth				1.80%	2.00%	3.00%	1.00%	0.80%	2.00%
Expected rates of return on plan assets	7.25%	6.75%	6.75%	5.00%	5.00%	3.00%	3.40%	3.40%	4.00%

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES:

a. **Commitments**:

1) Lease Commitments:

Some of the premises, warehouses and a site in the U.K. occupied by the Group are rented under various operating lease agreements. The lease agreements for the premises expire on various dates between 2006 and 2013.
Minimum lease commitments of the Company and its subsidiaries under the above leases, at rates in effect on 31 December 2006, are as follows:

	$ in thousands
Year ending 31 December:	
2007	1,999
2008	546
2009	415
2010	415
2011	415
2012-2013	1,549
	5,339

Rental payments for the premises in Israel and in the U.K. are payable in U.S. dollars and in the U.K. in Pounds Sterling, respectively.

Rental expenses totaled $ 2,009 thousands, $ 1,877 thousands and $ 1,426 thousands, in the years ended 31 December 2006, 2005, and 2004, respectively. The rental expenses for 2006 include $ 1,549 thousands in respect of premises for which the rental agreements are renewed every year.

2) Royalty Commitments:

(a) The Group and several third parties entered into agreements whereunder the Group acquired licenses for use of knowhow for the purpose of developing products. The Group will pay the third parties royalties at a range of rates of the sale of products developed, or a fixed amount in respect of each product sold.

(b) Frutarom Ltd. is committed to pay royalties to the Government of Israel on proceeds from sales of products in the research and development of which

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES (continued):

the Government participates by way of grants. Under the terms of Company's funding from the Israeli Government, royalties of 3%-5% are payable on sales of products developed from a project so funded, up to 100% of the amount of the grant received by the Frutarom Ltd. (dollar linked); as from 1 January, 1999 – with the addition of an annual interest rate based on Libor.

The maximum royalty amount payable by Frutarom Ltd. at 31 December 2006 is $ 489 thousands.

In 2006, Frutarom Ltd. was of the opinion that it would not be required to refund Chief Scientist grants in the total amount of $ 187 thousands, therefore it carried this amount to income.

b. Contingent Liabilities:

1) Reimbursement of expenses arising from raise of capital
As part of a capital raise made by the Company in the London Stock Exchange (see note 12b), the Company and the Bank of New York (hereafter – the bank) signed, in February 2005, an agreement, whereunder the bank would allocate the GDRs issued in the LSE as part of the above capital raise, and would serve as the trustee for those GDRs.
In consideration, the bank agreed to undertake the expenses arising from the said raise of capital ($ 810 thousands); under this agreement, the bank also undertook to bear further expenses of up to $ 270 thousands, relating to quoting the GDRs in future years.
Under the said agreement, the Company might be required to reimburse the expenses paid by the bank (with the addition of $ 500 thousands) if one of the suspending conditions of the agreement, which pertain to cease of quoting the GDRs, the reduction of such quoting, or a change in ownership, is met. Under the agreement, such reimbursement of expenses might be required for a seven-year period, commencing the date of capital raise. Since not all the suspending conditions specified in the agreement are under the control of the Group, and in light of the uncertainties concerning this matter, the Company recognized in its accounts a liability to the bank in an amount that is equal to the total amount paid by the bank in respect of capital raise expenses (Note 20).
Should the Company not be required to reimburse the expenses as above, the said amount would be credited to Company's shareholders' equity.

2) Legal Procedures against the Company and Subsidiaries
(a) In September 2001, Pikanti Meat Industries (1982) Ltd. and Hevrat Nitsolat Hacartel Ltd. (the "Plaintiffs"), lodged a claim for damages against Osem Food Industries Ltd. of the Nestle group and 16 other leading companies in the Israeli food industry (including Frutarom Trade and Marketing (1990)). The Plaintiffs claim that the defendants have created a cartel to destroy the activity of the Plaintiffs; they also claim that at a certain date the defendants ceased to supply them goods. In the opinion of Group's management, based on the opinion of its legal advisors, the claim has no factual basis. Total amount claimed was $ 108 million; the amounts claimed from each defendant was not specified. Since the plaintiffs did not pay the court fees, in 2003, the claim was cancelled.
In January 2004, the Plaintiffs lodged a new claim with a similar cause of action against Frutarom Trade and Marketing (1990) and 28 other companies.

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES (continued):

The amount claimed was $ 217 million. The Plaintiffs attached to the claim an application for remission from payment of court fees. This application was rejected by the Court and so was the plaintiff's appeal against the Court's rejection of the said application; further to the rejection of the application and nonpayment of the court fees the claim was abated. The plaintiffs have appealed against the abatement of the claim. The Group's management believes, based on its legal counsel's opinion, that even in the case that the said appeal would be allowed, that the claim is a vexatious and frivolous claim, has no factual basis, the facts included therein concerning Frutarom are in themselves erroneous, and that the chances that the application will be allowed and that the claimants will prevail in the claim are remote.

(b) A number of claims and third party notices have been filed against the Group. The claims are for bodily injury and economic damages, which the plaintiffs allege resulted from the pollution of the Kishon River, for which – according to the plaintiffs – the Group was among those responsible. Group's management believes, based on the opinion of its legal counsel, that the chances that the plaintiffs will prevail in the claims are remote. Group also believes that even if it will be found liable due to the circumstances of the said claim, the potential damage that might arise to the Group is immaterial, due to the large number of defendants, the very small quantity of effluents discharged by the Group during the relevant years (about 0.01% of total effluents discharged by the other defendants); due to the fact that effluents discharged by the Group cannot cause the damages allegedly caused and due to the period during which effluents were discharged by the Group compared with the other defendants. Commencing in 2000, the Group discontinued discharge of all effluents to the Kishon River.
Set forth below are the claims filed against the Group concerning the pollution of the Kishon River:

(1) As part of a claim, the amount of which was not specified, and which was filed by a former serviceman in the Israeli navy and other plaintiffs against Haifa Chemicals Ltd. ("HCL") for alleged bodily injury caused to the plaintiffs while diving in the Kishon River in the course of their military service, HCL sent the Group and other parties third party notices; in these notices, HCL demands that if the Court will find it liable for the damages caused to the plaintiffs, the third parties will bear part of the compensation to be paid to the plaintiffs, since those third parties were among those responsible for the pollution.

(2) As part of a claim, the amount of which was not specified, and which was filed by fishermen who developed cancer and by their relatives against HCL and other parties, for alleged bodily injury, allegedly caused as a result of the pollution of the Kishon River by the defendants, the defendants sent the Group and other parties third party notices; in these notices, the defendants demand that if the Court will find them liable for the damages caused to the plaintiffs, the Group and the other parties will bear part of the compensation to be paid to the fishermen and/or indemnify the defendants for payment of such compensation. The number of plaintiffs participating in this claim increases from time to time, since other fishermen, who developed cancer continue to join the claim.

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES:

(3) A class action was filed against the HCL and other entities, under Section 10 to the Law for the Abatement of Environmental Nuisances (Civil Claims), 1992. According to the claim, the defendants have been polluting the Kishon River, in such a manner as to interfere with the activities of the plaintiffs, and that the pollution causes the destruction of natural resources and poses a real danger to public health. The claimants request the Court to order the cessation of the discharge of effluents into the Kishon River and the restoration of the river to its state prior to the discharge of the effluents. Some of the defendants sent the Group and other parties third party notices; in those notices the defendants claim that if they will be required to bear the expenses incidental to restoration of the Kishon River to its state prior to the discharge of effluents as above, the Group and the other parties will be required to indemnify them in respect of those expenses.

(4) On 15 January 2004, Israel Shipyards Ltd. lodged a claim in the amount of $ 4.8 million against the Group and 11 other entities for economic damages allegedly caused as a result of the discharge of effluents to the Kishon River.

(c) In addition to the aforementioned, subsidiaries of the Group are a party to legal procedures in the ordinary course of business; in the opinion of Group's management the said legal procedures do not materially affect the Group's financial position. Some of the claims are covered by insurance policies and in respect of the other claims, the Group has fully provided in its accounts.

NOTE 12 – SHAREHOLDERS' EQUITY:

a. Share Capital:

1) Composed of ordinary shares of NIS 1 par value, as follows:

	Number of shares in thousands and the amount thereof, denominated in NIS		
	31 December		
	2006	**2005**	**2004**
Authorized	100,000	100,000	60,000
Issued and paid	57,676	57,676	46,276

Company registered shares are quoted on the TASE at NIS 36.69 ($ 8.68) per share as of 31 December 2006. The GDRs representing the Company's shares are quoted on the LSE.

2) Ordinary Company shares of NIS 1 par value, held by its subsidiary and included in the issued and paid share capital constitute 1.33% (765,693 shares) and 1.42% (819,339 shares) of the balance of ordinary issued and paid shares of this type as of 31 December 2006 and 2005, respectively.

NOTE 12 – SHAREHOLDERS' EQUITY (continued):

b. Capital Raise

On 22 February 2005, the Company completed a public offering in the London Stock Exchange, in which it raised capital in the total amount of $ 76 million (net of issuance costs at the amount of $ 5 million) as against the allocation of 10,600,000 ordinary Company shares and of listing of Global Depositary Receipts (hereafter – GDRs) in the official list of the UK Listing Authority; each GDR represents one Company share; the price per share was $ 7.63.

The allocation of shares and GDRs has taken place in two stages: in the first stage, on 8 February 2005, 10,000,000 Company shares were issued and GDRs were listed as above. In the second stage, on 22 February 2005, the underwriters fully exercised an option they were granted in the first stage, for the sale of additional 600,000 shares, at the price mentioned above.

Commensurate with the said allocation, ICC Handles AG of the ICC group – the Company's controlling shareholder – sold 2,600,000 existing Company shares at the price mentioned above. The Company did not receive any consideration in respect of the shares sold by ICC Handles AG.

c. Employee Share Option Plan for Senior Employees of Subsidiaries:

1) In 1996, the Company's Board of Directors approved an employee stock purchase plan (the "1996 Plan"), whereunder a subsidiary purchases Company shares in the TASE, for the purpose of granting the shares to senior employees of the Company.

The rights to purchase the shares are granted to the employees twice a year. The senior employees have the right to exercise the shares they were granted at the end of the vesting period. The vesting period of the shares granted under this plan is spread over three equal, annual batches: one year, two years and three years from date of grant.
In any case, an employee's right, as above, expires six years from the date such right was granted.

The exercise price is determined in accordance with the batch in which the shares were purchased. The exercise price for each batch constitutes 33.3% of the average price paid by the subsidiary upon purchase of Company shares.

This plan is intended to be governed by the terms stipulated by Section 102 of the Israeli Income Tax Ordinance. Those terms stipulate, inter alia, that the company is entitled to claim, as an expense for tax purposes, the amounts credited to the employees as a benefit in respect of shares or options granted under the plans.

In 2003, in light of the changes in the provisions of the Income Tax Ordinance relating to grant of shares and options to employees, the company's Board of Directors approved an employee stock option plan (hereafter – the 2003 plan), which replaces the 1996 plan.

NOTE 12 – SHAREHOLDERS' EQUITY (continued):

The terms of the shares granted under the 2003 during the years 2003-2006 are identical to the terms of the shares granted under the 1996 plan.
This plan is intended to be governed by the terms stipulated by Section 102 of the Israeli Income Tax Ordinance.

In accordance with the track chosen by the company and pursuant to the terms thereof, the company is not allowed to claim, as an expense for tax purposes, the amounts credited to employees as a benefit, including amounts recorded as salary benefits in the company's accounts, in respect of options granted to employees under the plan - with the exception of the work-income benefit component, if any, determined on the grant date.

2) Set forth below are data regarding the rights for shares under the 1996 Plan and the 2003 Plan, which have not yet been exercised by Company employees, as of 31 December 2006:

Year of grant	Number of shares in respect of which the vesting period ended	Number of shares in respect of which the Vesting period has not yet ended	Exercise price $
2001	16,295		0.29.0.31
2002	69,731		0.40-0.41
2003	58,802		0.81-1.40
2004	91,630	56,441	1.58-1.91
2005	56,264	117,748	2.65-2.70
2006		169,206	2.44-2.64
	292,722	343,395	

As of 31 December 2006, the remaining amount of compensation, computed as the excess or the fair value of the said ordinary shares granted to employees over the exercise price at the date of grant not yet recorded as expenses in the income statements, is approximately $ 1,025 thousands. The said remaining compensation will be charged to income using the accelerated method over the remaining vesting period.

As to shares granted to a manager in the Company - Note 24a2).

The changes in the number of rights for shares outstanding and their related weighted average exercise prices are as follows:

	2006		2005		2004	
	Average exercise price in U.S. $ per share	Rights for shares	Average exercise price in U.S. $ per share	Rights for shares	Average exercise price in U.S. $ per share	Rights for shares
At 1 January	1.33	695,172	0.87	763,961	0.51	909,699
Granted	2.40	169,206	2.46	191,613	1.69	203,669
Forfeited	2.24	(20,290)	0.74	(67,019)	0.46	(32,621)
Exercised	0.72	(207,971)	0.51	(193,383)	0.32	(316,786)
At 31 December	1.97	636,117	1.33	695,172	0.87	763,961

NOTE 12 – SHAREHOLDERS' EQUITY (continued):

The following table summarises information about share rights outstanding at 31 December 2006:

Share rights outstanding			Share rights exercisable		
Range of exercise prices	Number outstanding at 31 December 2006	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at 31 December 2006	Weighted average remaining contractual life
$		Years	$		Years
0.29	918	0.25	0.29	918	0.25
0.31	15,377	0.75	0.31	15,377	0.75
0.40	16,114	1.25	0.40	16,114	1.25
0.41	53,617	1.75	0.41	53,617	1.75
0.81	29,682	2.25	0.81	29,682	2.25
1.40	29,120	2.75	1.40	29,120	2.75
1.58	80,755	3.25	1.58	50,041	3.25
1.91	67,316	3.75	1.91	41,589	3.75
2.65	81,578	4.25	2.65	26,100	4.25
2.70	92,434	4.75	2.70	30,164	4.75
2.64	99,841	5.25			
2.44	69,365	5.75			
	636,117			292,722	

3) On 21 December 2003, the Company's Board of Directors resolved to issue up to 1,200 thousands ordinary shares of NIS 1 par value, to be registered for trade in TASE and to be allotted to senior executive employees.

On 18 January 2004, the Company designated 900 thousands shares to senior employees, as part of the said resolution. The market value of Company's shares at date of designation was NIS 19.64 ($ 4.46).

The allotted shares are to be held by a trustee. As from the date of allotment, the shares vest in equal batches, as follows: half a year (1 July 2004), one year (1 January 2005), two years (1 January 2006) and three years (1 January 2007).

In consideration of the shares, the employees paid NIS 5 ($ 1.14) per share, using a non-recourse loan they received for that purpose from the Company. In case that an employee as above will not complete the vesting period, the Company will repurchase from that employee the shares as against the offset of the employee's debt to the Company. The loans to the employees are in NIS and they are unlinked and bear no interest. The loans are repayable upon sale of the share, or within 60 days from termination of the employee's employment, whichever is earlier, but not later than 1 January 2010.
Through 31 December 2006, the employees repaid a total of $ 398 thousands out of the loans they were granted (2005 - $ 222 thousands, 2004 - $ 111 thousands).

NOTE 12 – SHAREHOLDERS' EQUITY (continued):

In June 2005, a senior employee resigned his office in the Company. The Company repurchased from the employee 125,000 shares, the vesting period of which has not yet been completed, as against the employee's debt to the Company.

The shares will be released to the senior employees upon payment of the said loans (an amount of NIS 5 per each share released), but not before the end of the vesting period.

The fair value of the allotted shares – computed using the Black & Scholes shares valuation model, amounted at date of grant to U.S. $ 3,024 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 33% - 39%, annual risk-free interest at a rate of 1.24%, 1.24%, 1.76% and 2.27% (in accordance with the option's expected life) and an expected average option life until exercise: six months for the first batch, one year for the second batch, two years for the third batch and three years for the fourth batch.

The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of weekly share price over the last six months, one year, two years and three years (in accordance with the vesting periods of the batches).

As to shares granted to manager in the Company – Note 24a2).

d. Allotment of Options to Senior Employees

1) On 17 May 2004, the Company's Board of Directors approved, as part of the 2003 Plan (Note 12c) and as part of the Board of Directors' resolution to issue 1.2 million ordinary shares, the allotment of 150,000 non-marketable options (the "Options") to a senior employee 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 employee in equal batches at the end of the vesting period. The vesting periods are as follows: the first batch vests on 9 October 2004; the second on 9 October 2005; the third on 9 October 2006 and the fourth on 9 October 2007. In any case, the employee's right to exercise the options expires six years from date of grant (on 17 May 2010). The exercise price was set to NIS 10.87 ($ 2.36). The market value of the Company's shares at date of allotment was NIS 20.94 ($ 4.55). On 16 June 2004, the Tel-Aviv Stock Exchange approved the registration of 150,000 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. $ 346 thousands. This value is based on the following assumptions: expected dividend at a rate set to 0% in all years; standard deviation of expected share price returns of 33.3%, - 39.5%, annual risk-free interest at a rate of 1.74%, 1.74%, 2.82% and 3.1% (in accordance with the option's expected life) and an expected average option life until exercise: five months for the first batch, seventeen months for the second batch, twenty nine months for the third batch and fourty one months for the fourth batch.

NOTE 12 – SHAREHOLDERS' EQUITY (continued):

The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of weekly share price over the last five months, seventeen months, twenty nine months and forty one months (in accordance with the vesting periods of the batches).

2) On 2 January 2006, the Company's Board of Directors approved, as part of the 2003 Plan (Note 12c) the allotment of 725,000 non-marketable options (the "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 form 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 ($ 6.75). The market value of the Company's shares at date of allotment was NIS 34.52 ($ 7.50).

On 31 January 2006, 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. 125,000 stocks out of the said amount are existing stocks held by Frutarom Ltd.

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; 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.

The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of weekly share price over the last twelve months, twenty four months and thirty six and fourty eight months (in accordance with the vesting periods of the batches).

As to the fair value of options granted to a manager – Note 24a2).

e. Dividend and Retained Earnings

The amounts of the dividend paid presented in the statement of changes in shareholders' equity are net the share of a subsidiary holding Company shares (Note 2L). The subsidiary's share in the dividend is $ 26 thousands, $ 23 thousands and $ 19 thousands in 2006, 2005 and 2004, respectively.
In determining the amount of retained earnings available for distribution as a dividend, the Companies Law stipulates that the cost of the Company's shares acquired by a subsidiary (that are presented as a separate item on the statement of changes in shareholders' equity) have to be deducted from the amount of retained earnings presented among Company's shareholders' equity.

NOTE 13–TAXES ON INCOME:

a. Corporate taxation in Israel

1) Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (hereafter - the inflationary adjustments law)

Under the inflationary adjustments law, results for tax purposes are measured in real terms, having regard to the changes in the CPI. The Company and the Israeli subsidiaries are taxed under this law.

2) Tax rates

The income of the Company and its Israeli subsidiaries (other than income from ”approved enterprises”, see b. below) is taxed at the regular rate. Through December 31, 2003, the corporate tax was 36%. In July 2004, Amendment No. 140 to the Income Tax Ordinance was enacted. One of the provisions of this amendment is that the corporate tax rate is to be gradually reduced from 36% to 30%. In August 2005, a further amendment (No. 147) was published, which makes a further revision to the corporate tax rates prescribed by Amendment No. 140. As a result of the aforementioned amendments, the corporate tax rates for 2004 and thereafter are as follows: 2004 – 35%, 2005 – 34%, 2006 – 31%, 2007 – 29%, 2008 – 27%,
2009 – 26% and for 2010 and thereafter – 25%.

As a result of the changes in the tax rates, the Group and adjusted - in each of the years 2004 and 2005 – at the time the aforementioned amendments were made, its deferred tax balances, in accordance with the tax rates expected to be in effect in the coming years; the effect of the change has been carried to income on a current basis.

Capital gains (other than the real capital gain on the sale of marketable securities - which is subject to tax at the regular rates) are taxed at a reduced rate of 25% on the capital gains derived after January 1, 2003, and at the regular corporate tax rates on the capital gain derived through the aforementioned date.

b. Subsidiaries outside Israel

Subsidiaries that are incorporated outside of Israel are assessed for tax under the tax laws in their countries of residence. The principal tax rates applicable to subsidiaries outside Israel are as follows:

Company incorporated in the USA – tax rate of 41%.
Company incorporated in Germany– tax rate of 40%.
Company incorporated in Belgium – tax rate of 34%
Company incorporated in the UK – tax rate of 30%.
Company incorporated in the Switzerland – tax rate of 22%.

NOTE 13 –TAXES ON INCOME (continued):

c. Encouragement Laws in Israel

1) Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (hereinafter - the Law)

Under the law, including Amendment No. 60 to the law that was published in April 2005, by virtue of the “approved enterprise” or “benefited enterprise” status granted to certain enterprises of the Company, and by virtue of the “Foreign Investors’ Company“ status it was granted, Frutarom Ltd. is entitled to various tax benefits.

The main tax benefits available to Frutarom Ltd. are:

(a) Reduced tax rates

During the 10-year period of benefits, commencing in the first year in which Frutarom Ltd. earns taxable income from the approved enterprises (provided the maximum period to which it is restricted by law has not elapsed), the following reduced tax rates apply:

(1) Corporate tax at the rate of 20% on income from certain approved or benefited enterprises owned by foreign investors' companies (this tax rate is determined based on the percentage of foreign shareholding as defined by the law, for each year).

(2) Tax exemption on income from certain approved or benefited enterprises in respect of which Frutarom Ltd. has elected the "alternative benefits" (involving waiver of investment grants); the length of the exemption period is two or four years, after which the income from these enterprises is taxable at a decreased rate (see 1a above) for an additional eight or six years, respectively.
In the event of distribution of cash dividends out of income, which was tax exempt as above, Frutarom Ltd. would have to pay the decreased tax rate (see 1a above) in respect of the amount distributed, (Note 2L4)).
The proportion of the taxable income entitled to benefits of reduced tax rates is calculated on the basis of the ratio between the turnover of the “approved enterprise” or the “benefited enterprise” and the whole turnover of Frutarom Ltd. The turnover applicable to the “approved enterprise” is calculated, as a general rule, by taking the increase resulting from the comparison of the turnover with its “base” turnover, which is prescribed as being the turnover during the last year before the activation of the “approved enterprise”, or such other basis as is stipulated in the instrument of approval.
In 2003, Frutarom Ltd. addressed the Investment Centre, requesting to recognise Frutarom Ltd. as an R&D intensive and labour-intensive company, which is characterised by a rapid technological turnover. In September 2005 the Investment Centre notified Frutarom Ltd. that two of its approved enterprises are recognised as approved enterprises that are characterised by a rapid technological turnover, for which Frutarom Ltd. is entitled to tax benefits by virtue of the Investment Centre’s base turnover procedure (an erosion of base turnover at a rate of 10% commencing in

NOTE 13 –TAXES ON INCOME (continued):

the first year of operation). Pursuant to the Investment Centre's notification, Frutarom Ltd. included in its books a tax benefit in the amount of $ 1.7 million in respect of prior years. At the beginning of 2006, the Investment Centre informed the company that it recognises another approved enterprise of Frutarom Ltd. as an approved enterprise characterised by a rapid technology turnover; the tax benefits to which the company would be entitled to receive in respect of this approved enterprise are similar to the tax benefits it receives in respect of the other two enterprises. Accordingly, Frutarom Ltd. recorded in 2006 a tax benefit receivable in respect of previous years in the total amount of $ 1 million. Frutarom Ltd.'s request to recognise an additional approved enterprises as an approved enterprise characterised by a rapid technology turnover has not yet been granted.
The period of benefits in respect of those of the abovementioned enterprises, which were activated, expires in the years 2006 through 2011.

2) Accelerated depreciation

Frutarom Ltd. is entitled to claim accelerated depreciation for five tax years commencing in the first year of operation of each asset, in respect of buildings, machinery and equipment used by the approved enterprise.

3) Conditions for entitlement to the benefits

The entitlement to the above benefits is conditional upon fulfilling the conditions stipulated by the law, regulations published thereunder and the instruments of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be cancelled and Frutarom Ltd. may be required to refund the amount of the benefits, in whole or in part, with the addition of interest.
Group's management believes that as of 31 December 2006, Frutarom Ltd. fulfills all the requirements.

d. The Law For The Encouragement of Industry (Taxation), 1969:

Frutarom Ltd. is an "industrial company" as defined by this law. As such, Frutarom Ltd. is entitled to claim amortisation over 8 years of acquired product formulas, as well as depreciation at increased rates for equipment used in industrial activity as stipulated by regulations published under the inflationary adjustments law, and have done so.

NOTE 13 – TAXES ON INCOME (continued):

e. Deferred Taxes:

1) The composition of the deferred taxes, and the changes therein during the year are as follows:

	In respect of balance sheet items						
			Provision for employee rights				
	Depreciable fixed assets	Negative goodwill	Severance pay	Vacation and recreation pay	Inventories	Other	Total
	U.S. dollars in thousands						
Balance at 31 December 2003	6,443	(1,816)	(493)	(341)	(579)	(329)	2,885
Changes in 2004:							
Adjustment to purchase price of Flachsmann (Note 5a)		(23)					(23)
Addition to deferred taxes in respect of acquisition of the FS from IFF (Note 5b)			(1,082)		274		(808)
Differences from translation of foreign currency financial statements of subsidiaries	226	(179)	(109)		39	(34)	(57)
Amounts carried to income	(89)	233	(138)	(83)	(504)	(142)	(723)
Balance at 31 December 2004 – brought forward	6,580	(1,785)	(1,822)	(424)	(770)	(505)	1,274

NOTE 13 – TAXES ON INCOME (continued):

	In respect of balance sheet items						
			Provisions for employee rights				
	Depreciable fixed assets	Negative goodwill	Severance pay	Vacation and recreation pay	Inventories	Other	Total
	U.S. dollars in thousands						
Balance at 31 December 2004 - brought forward	6,580	(1,785)	(1,822)	(424)	(770)	(505)	1,274
Derecognition of the balance of recognised negative goodwill as at 31 December 2004, net, in accordance with the transition provisions of IFRS 3 (Note 1c)		1,785					1,785
Differences from translation of foreign currency financial statements of subsidiaries	(420)		216		(80)	(2)	(286)
Amounts carried to income	295		(440)	22	565	856	1,298
Balance at 31 December 2005 - brought forward	6,455	-,-	(2,046)	(402)	(285)	349	4,071

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

	In respect of balance sheet items							
		Provisions for employee rights						
	Depreciable fixed assets	Severance pay	Vacation and recreation pay	Inventories	Other	Depreciable intangibles	In respect of carryforward tax losses	Total
	U.S. dollars in thousands							
Balance at 31 December 2005 – brought forward	6,455	(2,046)	(402)	(285)	349		-,-	4,071
Changes in 2006:								
Addition to deferred taxes in respect of acquisition of the subsidiaries (Note 5c;5d)	655	(62)		(172)	(244)	4,378		4,555
Differences from translation of foreign currency financial statements of subsidiaries	397	(177)		53	43	351	(69)	598
Amounts carried to income	571	562	(5)	140	(215)	(259)	(1,610)	(816)
Balance at 31 December 2006	8,078	(1,723)	(407)	(264)	(67)	4,470	(1,679)	8,408

NOTE 13 –TAXES ON INCOME (continued):

2) Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

3) Classification of deferred tax assets and liabilities by maturities, are as follows:

	31 December		
	2006	**2005**	**2004**
	U.S. dollars in thousands		
Deferred tax assets:			
Deferred tax asset to be recovered within 12 months	3,833	1,701	1,846
Deferred tax asset to be recovered after more than 12 months		1,618	1,111
	3,833	3,319	2,957
Deferred tax liabilities:			
Deferred tax liability to be recovered within 12 months	1,142	1,363	
Deferred tax liability to be recovered after more than 12 months	11,099	6,027	4,231
	12,241	7,390	4,231
	8,408	4,071	1,274

4) The deferred taxes in respect of activities in Israel are computed at the tax rate of 28% (2005 – 28%). This rate is an average taking into account the income from Frutarom Ltd.'s approved enterprises.

Deferred taxes of foreign subsidiaries in Switzerland, U.S.A., U.K., Germany, China and Belgium are computed at the tax rates applicable to these companies (see b above).

5) Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group did not recognise deferred income tax assets of \$ 49 thousands in respect of losses relating to the Company and to subsidiaries in Russia and Ukraine amounting to \$ 195 thousands that can be carried forward against future taxable income.

Deferred income tax liabilities of approximately \$ 4,676 thousands in 2006 have not been recognised for the withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries. Such amounts are permanently reinvested.

NOTE 13 –TAXES ON INCOME (continued):

f. Taxes on Income Included in The Income Statements:

1) As follows:

	2006	2005	2004
	U.S. dollars in thousands		
For the reported year:			
Current	8,724	6,877	5,632
Deferred, see e. above:			
In respect of a change in tax rates, Note 13a2)(a)		(115)	(40)
For the reported year	(816)	1,413	(683)
	7,908	8,175	4,909
For previous years	(1,000)	(1,700)	
T o t a l	6,908	6,475	4,909

Current taxes (consolidated) are computed at an average tax rate of 23.83%, 20.11% and 21.60%, for the years 2006 2005, and 2004, respectively.

NOTE 13 –TAXES ON INCOME (continued):

2) Theoretical tax reconciliation:

Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the regular tax rates applicable to companies in Israel (Note 13d above) and the actual tax expense:

	2006	2005	2004
	U.S. dollars in thousands		
Income before taxes on income, as reported in the income statements	36,610	33,322	20,665
Theoretical tax expense in respect of this income – at 31% (2005 – 34%; 2004 – 35%)	11,349	11,329	7,233
Less – tax benefits arising from approved enterprise status	(645)	(1,239)	(708)
	10,704	10,090	6,525
Increase (decrease) in taxes resulting from:			
Different tax rates applicable to foreign subsidiaries	(2,212)	(2,173)	(1,240)
Computation of deferred taxes at a rate which is different from the theoretical rate	35	62	202
Increase in taxes resulting from adjustment to deferred tax balances due to changes in tax rates (Note 13a2)a) above)		(115)	(40)
Disallowable deductions	18	160	898
Decrease in taxes resulting from utilization, in The reported year, of carryforward tax losses for which deferred taxes were not created net of increase in taxes in respect of tax losses incurred in the reported year for which deferred taxes were Not created	(27)	(839)	(1,331)
Difference between the basis of measurement of income reported for tax purposes and the Basis of measurement of income for financial reporting purposes – net*	(918)	1,028	
Other	308	(38)	(105)
Taxes on income for the reported year	7,908	8,175	4,909

* The said difference results from the difference between the changes in the CPI - which is used as the basis for calculating the results for tax purposes for the activity in Israel – see a1) above – and the changes in the NIS/dollar exchange rate.

g. Tax Assessments:

The Company and one of the Israeli subsidiaries have received tax assessments through the year 1999.

Frutarom Ltd. received final tax assessments through the year 1998.

Tax assessments filed by the Company and the Israeli subsidiaries through the year ended 31 December 2001 are considered to be final.

NOTE 14 – LIABILITIES SECURED BY PLEDGES AND RESTRICTIONS PLACED IN RESPECT OF LIABILITIES:

a. To secure long-term bank loans and credit and short-term bank credit granted to subsidiaries of the Company in the U.S.A., U.K. and Switzerland, the subsidiaries have registered floating charges on their assets.

b. To secure long and short-term loans extended to Frutarom Ltd., this company registered fixed charges on its share capital and its goodwill, floating charges on all its assets and insurance rights and floating charges on all its assets including the rights and yield arising from the assets.
The charges were registered in favour of several bank; Frutarom Ltd. has also agreed not to register any pledges or transfer assets without the prior consent of the banks.

NOTE 15 – ACCOUNTS RECEIVABLE:

	31 December		
	2006	**2005**	**2004**
	U.S. dollars in thousands		
a. Trade:			
Open accounts	52,192	37,537	41,097
Related parties	403	526	719
	52,595	38,063	41,816
Cheques collectible	1,373	2,226	1,917
	53,968	40,289	43,733
The item includes – provision for impairment of receivables	2,201	1,726	2,186
b. Other:			
Employees	251	153	149
Related parties	255	355	530
Government institutions	4,112	2,144	2,081
Adjustments to purchase price of the FS (Note 5b)	2,305	2,071	3,535
Sundry	3,115	2,033	996
	10,038	6,756	7,291

NOTE 16 – INVENTORIES

	31 December		
	2006	2005	2004
	U.S. dollars in thousands		
Raw materials and supplies	26,509	22,624	21,126
Products in process	2,137	1,903	1,547
Finished products	29,428	20,755	18,840
	58,074	45,282	41,513
Inventories for commercial operations – purchased products	1,680	1,604	2,256
	59,754	46,886	43,769

NOTE 17 – OTHER NON-CURRENT ASSETS

	31 December		
	2006	2005	2004
	U.S. dollars in thousands		
Prepaid expenses – net-a	1,938	1,978	1,636
Long-term receivable-b			2,773
Deferred charges-c			349
	1,938	1,978	4,758

a. Prepaid expenses in respect of leasehold rights in land:

1) Frutarom Ltd. has a leasehold right in land located in the Akko Industrial Zone and the Haifa Bay. The net capitalised lease fees as at 31 December 2006, in respect of the said lands amount to $ 1,333 thousands. The leasing period is 49 years ending in the years 2032 through 2042. Frutarom Ltd. has a right to extend the leasing for an additional 49-year period.

2) In October 2003, Frutarom Ltd. and the Israel Lands Administration entered into an agreement in respect of additional leasing rights in land located in the industrial zone in the north of Israel. Leasehold rights in respect of this land are for a period of 49 years ending January 2053. Frutarom Ltd. has a right to extend the leasing period for additional 49 years.
During 2005, capitalised lease fees in the amount of $ 382 thousands were paid in respect of the said land.

3) A subsidiary in China has "Land Use Rights" on land in China. The rights are for a period of 50 years ending in 2046. Net capitalised lease fees as at 31 December 2006, in respect of the said land amount to $ 223 thousands.

b. Long-term receivable is in respect of sale of assets by a subsidiary in Switzerland; the balance was linked to the Swiss Franc and bears annual interest of 7% per year that was paid every quarter. The debt was due in 2006. The balance was repaid in one installment during 2005.

c. Deferred charges are in respect of issuance of Company shares in the LSE in February 2005 (Note 12b). These costs were charged to shareholders' equity on the date of issuance, as mentioned above.

NOTE 18 – CASH AND CASH EQUIVALENTS:

a. The cash and cash equivalents item is composed of the following balances:

	31 December		
	2006	2005	2004
	U.S. dollars in thousands		
Cash and cash equivalents	18,417	33,723	7,350
Bank overdrafts	(673)		(3,231)
	17,744	33,723	4,119

b. Classified by currency, linkage terms and interest rates, the cash and cash equivalents are as follows:

	Weighted interest rates as of 31 December 2006	31 December		
		2006	2005	2004
		U.S. dollars in thousands		
In Dollars	3.00%	6,333	19,016	3,460
In Pounds sterling		843	1,932	1,051
In Euro		8,066	8,877	813
In Swiss francs	0.13%	2,034	3,015	1,280
Other		1,141	883	746
		18,417	33,723	7,350

NOTE 19 – BANK CREDIT:

	31 December		
	2006	2005	2004
	U.S. dollars in thousands		
a. Composed as follows:			
Current maturities of long-term bank loans		289	5,605
Short-term credit from banks (Note 5c)	673		3,231
Short term bank loans in respect of acquisition of the FS business from IFF (note 5b)			41,519
	673	289	50,355

b. During 2005, the Company used the consideration it received in respect of the issuance of shares (Note 12b) to repay the remaining balance of short-term bank credit.

NOTE 20 – ACCOUNTS PAYABLE:

		31 December		
		2006	2005	2004
		U.S. dollars in thousands		
a.	Trade:			
	Open accounts	27,476	17,895	19,685
	Cheques payable	24		572
		27,500	17,895	20,257
b.	Other:			
	Payroll and related expenses	5,683	5,375	5,660
	Government institutions	13,362	8,159	7,230
	Liability for former shareholders of Flachsman			1,325
	Provision for commissions and discounts	1,467	1,325	1,162
	Parent and related companies		124	108
	Income received in advance		164	103
	Liability to Bank of New York (Note 11b1))	810	810	
	Accrued expenses	5,128	3,438	1,238
	Customer advances	140	270	258
	Sundry	1,407	2,497	3,634
		27,997	22,162	20,718

NOTE 21 – PROVISIONS FOR LIABILITIES AND CHARGES:

	Restructuring from Flachsmann acquisition	Claims and litigations	Total
	U.S. dollars in thousands		
Balance at 1 January	1,433	551	1,984
Changes during 2004:			
Changes in Group organisation:			
Adjustment to purchase price at Flachsmann acquisition (note 5a)	(220)		(220)
Utilised during the year	(628)		(628)
Additional provisions		9	9
Currency translation effects	48		48
Balance at 31 December 2004	633	560	1,193
Changes during 2005:			
Changes in company organization:			
Utilised during the year	(583)	(13)	(596)
Currency translation effects	(50)		(50)
Balance at 31 December 2005	-,-	547	547
Changes during 2006:			
Balance at 31 December 2006			
Additional provisions		399	399
Balance at 31 December 2006	-,-	946	946

Restructuring Provisions From Flachsmann Acquisition

Provisions for the Flachsmann acquisition have been recognised during the acquisitions for compensating Flachsmann's employees for terminating of their employment and closing certain Flachsmann's facilities (Note 5a). The provision was fully used until the end of 2005.

Claims and Litigation

These provisions are made in respect of legal claims brought against the Group and potential litigations. Related estimated legal fees are also included in these provisions (Note 11b).

NOTE 22 – INCOME STATEMENT ANALYSIS:

	2006	2005	2004
	U.S. dollars in thousands		
a. Cost of Sales:			
Industrial operations:			
Materials consumed	136,283	102,693	84,277
Payroll and related expenses	23,730	23,675	18,439
Depreciation and amortisation	7,642	7,232	5,523
Other production expenses	16,665	12,349	9,503
	184,320	145,949	117,742
Increase in work in process and finished products inventories	(8,907)	(1,914)	(873)
	175,413	144,035	116,869
Commercial operations – cost of products sold	5,957	5,250	5,578
	181,370	149,285	122,447
b. Selling, Marketing, Research and Development Expenses - net:			
Payroll and related expenses	25,488	23,291	18,050
Transportation and shipping	6,644	6,817	4,605
Provisions for payment of commissions and royalties	4,145	3,820	3,408
Provision for impairment of trade receivables	111	62	556
Depreciation and amortisation	1,763	832	582
Travel and entertainment	3,832	3,210	1,539
Office rent and maintenance	2,956	2,386	2,487
Other	3,579	3,400	3,327
	48,518	43,818	34,554
The item includes expenses for product development and research activities, net*	14,099	11,956	9,744
* net of participation from government departments and others	389	165	220

NOTE 22 – INCOME STATEMENT ANALYSIS (continued):

	2006	2005	2004
	U.S. dollars in thousands		
c. General and Administrative Expenses:			
Payroll and related expenses	13,656	10,611	11,329
Depreciation and amortisation	610	266	265
Professional fees	2,222	1,524	1,232
Communication, office supplies and maintenance	2,909	3,070	1,999
Insurance for office holders and costs related to Board of Directors	140	130	108
Travel and entertainment	1,335	928	762
Other	1,546	1,688	2,174
	22,418	18,217	17,869
d. Other income – net:			
Capital loss (gain) on sale of fixed assets	(23)	328	24
Rental	(65)	(49)	(34)
Impairment of property, plant and equipment and intangible assets	126		97
Negative goodwill arising from the acquisition of IFF (Note 5b)	(2,242)	(1,496)	
Sundry	90	(38)	(189)
	(2,114)	(1,255)	(102)
e. Financial Expenses – net:			
In respect of long-term loans and credit		512	1,351
In respect of exchange differences of trade receivables and trade payable balances – net	88	26	(322)
In respect of cash and cash equivalents, short-term deposits and loans, short-term credit and other – net	(53)	(122)	318
Periodic change in non-current liability (Note 5c)	410		
	445	416	1,347

NOTE 23 – CASH FLOWS FROM OPERATIONS

	2006	2005	2004
	U.S. dollars in thousands		
Net income	29,702	26,847	15,756
Adjustments required to reflect the cash flows from operating activities:			
Depreciation and amortization	10,015	8,330	6,370
Recognition of compensation related to employee stock and option grants	1,538	805	2,730
Liability for employee rights upon retirement - net	(1,168)	293	660
Deferred income taxes – net	(816)	1,298	(723)
Loss (gain) from sale of fixed assets	(23)	328	24
Increase (decrease) in provisions - net	399	(596)	(619)
Provision for impairment of intangibles in subsidiary	126		
Negative goodwill arising from the acquisition of IFF (Note 5b)	(2,242)	(1,496)	
Other	546	83	193
	8,375	9,045	8,635
Changes in working capital:			
Decrease (increase) in accounts receivable:			
Trade	(5,247)	944	(12,683)
Other	(1,744)	(1,375)	(438)
Increase (decrease) in accounts payable:			
Trade	4,938	(998)	5,201
Other	5,249	5,530	5,930
Increase in inventories	(4,884)	(5,562)	(1,373)
	(1,688)	(1,461)	(3,363)
Cash flows from operating activities	36,389	34,431	21,028
Non-cash transactions			
Change in excess of cost of acquisition (note 5c)	2,268		

NOTE 24 - RELATED PARTIES - TRANSACTIONS AND BALANCES:

a. Transactions with Related Parties:

1) Income (expenses):

	2006	2005	2004
	U.S. dollars in thousands		
Sales – affiliates (companies controlled by the controlling shareholder):			
Fallek Chemical Japan (hereafter "Fallek")	883	848	1,361
Other	12	90	126
	895	938	1,487

Goods are sold on the basis of the market prices with non-related parties.

	2006	2005	2004
Purchases:			
Affiliates (companies controlled by the controlling shareholder):			
Azur S.A. (hereafter – "Azur")	(400)	(328)	(382)
Controlling shareholder	(16)	(182)	(215)
	(416)	(510)	(597)

The agreement for rendering of services by Azur was approved by the shareholders' meeting. Goods are bought on the basis of the market prices with non- related parties.

	2006	2005	2004
Dividend	(717)	(691)	(535)
Other income (expenses):			
Affiliates:			
Azur	(61)	(58)	(63)
EIL		12	(19)
Fallek		(12)	(16)
	(61)	(58)	(98)
Controlling shareholder		(29)	(28)
	(61)	(87)	(126)
Benefits to related parties:			
Wages and salaries	(2,050)	(1,028)	*(883)
Director fees to 7 directors (in the Company)	(179)	(130)	(108)

* Not including benefit in respect of exercise and grant of shares in the year 2004 in the amount of $ 1,094 thousands.

2) Shares granted to a manager in the Company

The difference between the market value of the shares which were granted to a manager in the years 2006, 2005, and 2004 under 1996 plan (Note 12c) and the exercise price stipulated by the plans, as known at time of the grant is $ 155 thousands, $ 169 thousands and $ 116 thousands, respectively.

The compensation costs that have been charged to the income statements, in respect of the said shares granted in the years 2006, 2005, and 2004, are $ 125, $ 50 thousands and $ 35 thousands, respectively.

NOTE 24 – "RELATED PARTIES" – TRANSACTIONS AND BALANCES (continued):

As part of a Board resolution, a manager in the Company was granted, in 2004, rights to purchase 500 thousands shares; the fair value of shares that the Company allotted to a manager, computed using the Black & Scholes shares valuation model (based on the assumption as described in Note 12c3)), was estimated at the date of grant to $ 1,680 thousands (Note 12c3)).

As part of the Board resolution, a manager in the Company was granted, on 2 January 2006, 350 thousands options; the fair value of options that the Company allotted to a manager, computed using the Black & Scholes shares valuation model (based on the assumptions described in Note 12d2), was estimated at the date of grant to $ 783 thousands (Note 12d2).

3) The Company's articles of association allow for insurance and indemnification of office holders as permitted by Israeli law. The Company established indemnification policy in respect of its office holders and office holders of subsidiaries. The Company also resolved to insure office holders in respect of their duties, all subject to the provisions of the law and other limitations.

4) As to selling of shares by ICC Handles AG of the ICC group – the Company's controlling shareholder - see Note 12b.

b. Balances with Related Parties:

	31 December		
	2006	**2005**	**2004**
	U.S. dollars in thousands		
1) Current receivables - presented in the balance sheets among "other receivables" and "trade" under current assets - balance at balance sheet date - Affiliated:			
Fallek	403	526	719
Azur	250	318	479
Other	5	37	51
	658	881	1,249
Highest balance during the year	874	1,133	1,249
2) Current payables to parent company (excluding current maturities of long-term liabilities) – parent company		124	95
Affiliates			13
		124	108

NOTE 25 – SUBSEQUENT EVENT

On March 19, 2007 the group's Board of Directors declared the distribution of a dividend of NIS 0.18 per share. The total amount of the dividend is $ 2,457 thousands.

NOTE 26 – CONDENSED COMPANY DATA:

a. Balance sheet data:

	December 31 U.S. dollars in thousands		
	2006	**2005**	**2004**
A s s e t s			
Current assets - accounts receivable:	179	68	420
Fixed assets – net	139	139	139
Investments, loans and capital notes to subsidiaries	108,745	100,199	28,237
	109,063	100,400	28,796
Liabilities and shareholders' equity			
Current liabilities	105	64	31
Shareholders' equity (see c. below)	108,958	100,342	28,765
	109,063	100,400	28,796

b. Operating results data:

	2006	**2005**	**2004**
	U.S. dollars in thousands		
General and administrative expenses	72	384	205
Financing income (expenses) – net	7,807	(4,687)	293
Other income - net	156	156	156
Income in respect of dividend received	1,978	1,716	1,144
Net income for the year	9,869	(3,199)	1,388

NOTE 26 – CONDENSED COMPANY DATA (continued):

a. Changes in shareholders' equity:

	Share capital	Additional paid in capital	Retained earnings	Cost of company shares held by subsidiary	Total
BALANCE AS OF 1 JANUARY 2004	13,939	15,263	(2,021)	(600)	26,581
CHANGES IN 2004:					
Net income			1,388		1,388
Plan for allotment of Company shares to employees of subsidiary:					
Purchase of Company shares by subsidiary				(991)	(991)
Receipts in respect of allotment of Company shares to employees				90	90
Recognition of compensation related to stock and option grants to employees				440	440
Allotment of shares and options to senior employees:					
Receipts in respect of allotment of Company shares to employees	22	89			111
Recognition of compensation related to stock and option grants to employees		2,290			2,290
Dividend			(1,144)		(1,144)
BALANCE AT 31 DECEMBER 2004 – brought forward	13,961	17,642	(1,777)	(1,061)	28,765

NOTE 26 – CONDENSED COMPANY DATA (continued):

c. Changes in shareholders' equity:

	Share Capital	Additional paid in capital	Retained earnings	Cost of company shares held by subsidiary	Total
	U.S. dollars in thousands				
BALANCE AS OF 1 JANUARY 2005 - brought forward	13,961	17,642	(1,777)	(1,061)	28,765
CHANGES IN 2005:					
Net income			(3,199)		(3,199)
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 stock and option grants to employees		484			484
Dividend			(1,716)		(1,716)
BALANCE AT 31 DECEMBER 2005 – brought forward	16,399	91,666	(6,692)	(1,031)	100,342

NOTE 26 – CONDENSED COMPANY DATA (continued):

	Share capital	Additional paid in capital	Retained earnings	Cost of company shares held by subsidiary	Total
BALANCE AS OF 1 JANUARY 2005 – brought forward	16,399	91,666	(6,692)	(1,031)	100,342
CHANGES IN 2006:					
Net income			9,869		9,869
Plan for allotment of Company shares to employees of subsidiary					
Purchase of Company shares by subsidiary				(1,135)	(1,135)
Receipts in respect of allotment of Company shares to employees				146	146
Recognition of compensation related to stock and option grants to employees				229	229
Allotment of shares and options to senior employees:					
Receipts in respect of allotment of Company shares to employees	35	141			176
Recognition of compensation related to stock and option grants to employees		1,309			1,309
Dividend			(1,978)		(1,978)
BALANCE AT 31 DECEMBER 2006	16,434	93,116	1,199	(1,791)	108,958

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDAETD FINANCIAL STATEMENTS (continued)

NOTE 27 – LIST OF CONSOLIDATED SUBSIDIARIES

Name of company	Country	Percentage of shareholding and control 31 December 2006 %	2005 %	Comments
Subsidiaries:				
Frutarom Ltd.	Israel	100	100	
Frutarom Trust Ltd.	Israel	100	100	
Investees of Frutarom Ltd:				
Frutarom Trade and Marketing (1990)	Israel	100	100	
Galilee Essences Ltd.	Israel	100	100	Inactive company
Frutarom (UK) Ltd. (2)	U.K.	100	100	
International Frutarom Corporation (1)	U.S.A	100	100	
Frutarom Russia Ltd.	Russia	100	100	
Frutarom Ukraine Ltd.	Ukraine	100	100	
Frutarom Kazakhstan Ltd.	Kazakhstan	100	100	
Frutarom Flavors (Kunshan) Company	China	100	100	
Far Aromatic Gida Urunleri Sanayi Ve Ticaret Limited Sirketi Ltd.	Turkey	100	100	
Frutarom do Brazil	Brazil	100	100	

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDAETD FINANCIAL STATEMENTS (continued)

NOTE 27 – LIST OF CONSOLIDATED SUBSIDIARIES (continued):

(1) Holds full ownership in Frutarom U.S.A Inc. and Frutarom Inc.		
(2) Holds full ownership in:		
a) Frutarom Switzerland Ltd., which holds full ownership in the following companies:		
Frutarom Germany GmbH(3)		
Frutarom Nordic Als		
Flachsmann Properties Ltd.		Inactive company
Flachsmann Canada Ltd.		Inactive company
Frutarom Belarus Ltd.		
Frutarom (Marketing) S.R.L.		
Frutarom France S.A.R.L.		
Frutarom Belgium N.V.		
Frutarom Netherlands B.V.		
(3) Holds 70% in		
GewurzMuhle Nesse GmbH		
GewurzMuhle Nesse Gebr. Krause GmbH		
(4) Holds full ownership in		
Frutarom Specialities Belgium N.V.		
Frutarom U.S.A. Holding Inc.		
b) Turkish Holdings Ltd.	U.K.	Inactive company (in the process of cancellation from records of the registrar of companies)