

FRUTAROM INDUSTRIES LTD.
2012 FINANCIAL STATEMENTS

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REPORT OF THE AUDITORS

To the shareholders of

FRUTAROM INDUSTRIES LTD.

Regarding the audit of the components of internal control over financial reporting in accordance with section 9B(c) to the Israeli Securities Regulations (Periodic and Immediate Reports), 1970

We have audited components of internal control over financial reporting of Frutarom Industries Ltd. and its subsidiaries (hereinafter - the Company), as of December 31, 2012. These components of internal control were set as explained in the next paragraph. The Company's Board of Directors and Management are responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of components of internal control over financial reporting included in the accompanying periodic report for the above date. Our responsibility is to express an opinion on the components of internal control over financial reporting based on our audit.

Components of internal control over financial reporting were audited by us according to Audit Standard no. 104 of the Institute of Certified Public Accountants in Israel "Audit of the Internal Control Components over Financial Reporting" (hereafter - "Audit Standard 104"). These components are: (1) entity level controls, including controls on the preparation process and closing of the financial reporting and general controls of information systems, (2) controls over the process of purchasing process, consumption of materials and inventory (3) controls over the sales and receivables (all of these together are called the "audited control components").

We conducted our audits in accordance with Audit Standard 104. This standard requires that we plan and perform the audit to identify the audited control components and to obtain reasonable assurance whether these control components have been maintained effectively in all material respects. The audit includes obtaining an understanding of internal control over financial reporting, identifying the audited control components, assessing the risk that a material weakness exists in the audited control components, as well as review and assessment of effective planning and maintaining of these audited control components based on the estimated risk. Our audit, for those audited control components, also included performing such other procedures as we considered necessary under the circumstances. Our audit referred only to the audited control components, unlike internal control of all material processes over financial reporting, and therefore our opinion refers only to the audited control components. In addition, our audit did not take into account the mutual influences between the audited control components and those which are not audited, and therefore our opinion does not take into account such possible effects. We believe that our audit provides a reasonable basis for our opinion in the context described above.

Due to inherent limitations, internal control over financial reporting in general and components of internal controls in particular, may not prevent or detect a misstatement. Also, making projections on the basis of any evaluation of effectiveness is subject to the risk that controls may become inadequate because of changes in circumstances, or that the degree of compliance with the policies or procedures may be adversely affected.

In our opinion, the company effectively maintained, in all material respects, the audited control components as of December 31, 2012.

We also audited, the Company's financial statements as of December 31, 2012 and 2011 and for each of the three years in the period ended December 31, 2012, in accordance with generally accepted auditing standards, and our report, of March 12, 2013 included an unqualified opinion on these financial statements.

Haifa, Israel
12, March, 2013

Kesselman & Kesselman
Certified Public Accountants (Isr.)
A member firm of International PricewaterhouseCoopers Limited



REPORT OF THE AUDITORS

To the shareholders of

FRUTAROM INDUSTRIES LTD.

We have audited the consolidated statements of financial position of Frutarom Industries Ltd. (hereafter - the Company) as of December 31, 2012 and 2011 and the related consolidated statements of income, statements of comprehensive income, changes in equity and cash flows for each of the three years in the period ended on December 31, 2012. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain consolidated companies, whose assets included in consolidation constitute approximately 26% and 13% of total consolidated assets as of December 31, 2012 and 2011, and whose revenues included in consolidation constitute approximately 26%, 14%, and 13% of total consolidated revenues for each of the three years in the period ended December 31, 2012. The financial information of the above consolidated companies was audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to financial information 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 consolidated financial position of the company and its subsidiaries as of December 31, 2012 and 2011 and the consolidated results of their operations, changes in equity and their cash flows for each of the three years in the period ended on December 31, 2012, in accordance with International Financial Reporting Standards (hereafter – IFRS) .

We have also audited in accordance with standard No. 104 of the Institute of Certified Public Accountants in Israel “Audit of the Internal Control Components over Financial Reporting“, internal control components over financial reporting of the company as at December 31, 2012, and our report in March 12, 2013 included an unqualified opinion on the effectiveness of those components.

Haifa, Israel
12, March, 2013

Kesselman & Kesselman
Certified Public Accountants (Isr.)
A member firm of International PricewaterhouseCoopers Limited

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	<u>Note</u>	<u>As of 31 December</u>	
		<u>2012</u>	<u>2011</u>
		<u>U.S. dollars in thousands</u>	
A s s e t s			
CURRENT ASSETS:			
Cash and cash equivalents	18	53,933	36,472
Accounts receivable:	15		
Trade		106,754	86,054
Other		10,949	6,990
Prepaid expenses and advances to suppliers		6,966	5,916
Inventories	16	122,433	111,214
		<u>301,035</u>	<u>246,646</u>
NON-CURRENT ASSETS :			
Property, plant and equipment – net	7	188,824	145,455
Intangible assets – net	2f,8	279,198	255,710
Deferred income tax assets	13d	3,075	2,073
Other	17	379	67
		<u>471,476</u>	<u>403,305</u>
T o t a l assets		<u>772,511</u>	<u>649,951</u>

)
Dr. John 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: March 12, 2013.

	Note	As of 31 December	
		2012	2011
U.S. dollars in thousands			
Liabilities and Shareholders' Equity			
CURRENT LIABILITIES:			
Short-term bank credit and loans and current maturities of long-term loans	9	52,196	52,699
Accounts payable:	19		
Trade		48,237	40,239
Other		39,269	38,444
		<u>139,702</u>	<u>131,382</u>
NON-CURRENT LIABILITIES:			
Long-term loans net of current maturities	9	137,836	88,947
Retirement benefit obligations, net	10	13,229	11,359
Deferred income tax liabilities	13d	27,292	24,669
Other	5	892	-
		<u>179,249</u>	<u>124,975</u>
COMMITMENTS AND CONTINGENT LIABILITIES	11		
T o t a l liabilities		<u>318,951</u>	<u>256,357</u>
EQUITY:			
EQUITY ATTRIBUTED TO OWNERS OF THE PARENT COMPANY:			
Ordinary shares		16,713	16,597
Other capital surplus		102,099	97,356
Translation differences	2c	16,749	12,356
Retained earnings		318,807	270,266
Less - cost of Company shares held by the company and by subsidiary		<u>(3,043)</u>	<u>(2,981)</u>
Non-controlling interest		2,235	-
T o t a l equity		<u>453,560</u>	<u>393,594</u>
T o t a l equity and liabilities		<u>772,511</u>	<u>649,951</u>

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED INCOME STATEMENTS

	Note	Year ended 31 December		
		2012	2011	2010
		U.S. dollars in thousands, (except for per share data)		
SALES		618,001	518,443	451,066
COST OF SALES	20a	391,742	329,866	276,242
GROSS PROFIT		<u>226,259</u>	<u>188,577</u>	<u>174,824</u>
Selling, marketing, research and development expenses - net	20b	104,932	88,641	77,061
General and administrative expenses	20c	49,197	39,231	35,099
Other expenses (income) - net	20d	(718)	2,041	(318)
INCOME FROM OPERATIONS		<u>72,848</u>	<u>58,664</u>	<u>62,982</u>
FINANCIAL EXPENSES (INCOME) – net	20e	7,240	5,798	3,196
INCOME BEFORE TAXES ON INCOME		<u>65,608</u>	<u>52,866</u>	<u>59,786</u>
INCOME TAX	13e	13,628	10,835	15,675
NET INCOME FOR THE YEAR		<u><u>51,980</u></u>	<u><u>42,031</u></u>	<u><u>44,111</u></u>
PROFIT ATTRIBUTED TO:				
Owners of the parent company		51,570	42,031	44,111
Non-controlling interest		410	-	-
		<u>51,980</u>	<u>42,031</u>	<u>44,111</u>
		U.S dollars		
EARNINGS PER SHARE:	2v			
Basic		0.9	0.73	0.77
Fully diluted		<u>0.9</u>	<u>0.73</u>	<u>0.77</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	U.S. dollars in thousands		
Income for the year	51,980	42,031	44,111
Other comprehensive income -			
Translation differences	4,393	(5,255)	(452)
Total comprehensive income for the Year	<u>56,373</u>	<u>36,776</u>	<u>43,659</u>
Attributable to:			
Owners of the parent company	55,963	36,776	43,659
Non-controlling interest	410	-	-
Total	<u>56,373</u>	<u>36,776</u>	<u>43,659</u>

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

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Note	Ordinary shares	Other capital surplus	Translation differences	Retained earnings	Cost of company shares held by subsidiary	Total
BALANCE AT 1 JANUARY 2010	16,597	96,995	18,063	190,237	(3,417)	318,475
Comprehensive income:						
Income for the year	-	-	-	44,111	-	44,111
Other comprehensive income -						
Translation differences	2c	-	(452)	-	-	(452)
Total comprehensive income for the year		-	(452)	44,111	-	43,659
Plan for allotment of Company shares to employees of subsidiary:	2r					
Purchase of Company shares by subsidiary		-	-	-	(1,261)	(1,261)
Receipts in respect of allotment of Company shares to employees	12b	-	(1,344)	-	2,017	673
Allotment of shares and options to senior employees-	12b					
Recognition of compensation related to employee stock and option grants		-	979	-	-	979
Dividend paid	12c	-	-	(2,733)	-	(2,733)
		-	(365)	(2,733)	756	(2,342)
BALANCE AT 31 DECEMBER 2010	<u>16,597</u>	<u>96,630</u>	<u>17,611</u>	<u>231,615</u>	<u>(2,661)</u>	<u>359,792</u>

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	<u>Note</u>	<u>Ordinary shares</u>	<u>Other capital surplus</u>	<u>Translation differences</u>	<u>Retained earnings</u>	<u>Cost of company shares held by subsidiary</u>	<u>Total</u>
<u>U.S. dollars in thousands</u>							
BALANCE AT 1 JANUARY 2011		16,597	96,630	17,611	231,615	(2,661)	359,792
Comprehensive income:							
Income for the year		-	-	-	42,031	-	42,031
Other comprehensive income -							
Translation differences	2c	-	-	(5,255)	-	-	(5,255)
Total comprehensive income for the year		-	-	(5,255)	42,031	-	36,776
Plan for allotment of Company shares to employees							
of subsidiary:	2r						
Purchase of Company shares by subsidiary		-	-	-	-	(892)	(892)
Receipts in respect of allotment of Company shares to employees	12b	-	(382)	-	-	572	190
Allotment of shares and options to senior employees-	12b						
Recognition of compensation related to employee stock and option grants		-	1,108	-	-	-	1,108
Dividend paid	12c	-	-	-	(3,380)	-	(3,380)
		-	726	-	(3,380)	(320)	(2,974)
BALANCE AT 31 DECEMBER 2011		<u>16,597</u>	<u>97,356</u>	<u>12,356</u>	<u>270,266</u>	<u>(2,981)</u>	<u>393,594</u>

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

		Cost of company shares held by the company	Total attributed to owners of parent company	Non- controlling interest	Total			
Note	Ordinary shares	Other capital surplus	Translation differences	Retained earnings				
	U.S. dollars in thousands							
BALANCE AT 1 JANUARY 2012	16,597	97,356	12,356	270,266	(2,981)	393,594	-	393,594
Comprehensive income:	-	-	-	51,570	-	51,570	410	51,980
Income for the year								
Other comprehensive income -								
Translation differences	2c	-	4,393	-	-	4,393	-	4,393
Total comprehensive income for the year		-	4,393	51,570	-	55,963	410	56,373
Plan for allotment of Company shares to employees of subsidiary:								
Purchase of Company shares by subsidiary	2r	-	-	-	(1,330)	(1,330)	-	(1,330)
Receipts in respect of allotment of Company shares to employees	12b	-	(846)	-	1,268	422	-	422
Allotment of shares and options to senior employees- Recognition of compensation related to employee stock and option grants	12b	-	1,553	-	-	1,553	-	1,553
Proceeds from issuance of shares to senior employees		116	4,036	-	-	4,152	-	4,152
Dividend paid	12c	-	-	(3,029)	-	(3,029)	-	(3,029)
		16,713	102,099	16,749	318,807	(3,043)	451,325	410
Non-controlling interest from business combination		-	-	-	-	-	1,825	1,825
BALANCE AT 31 DECEMBER 2012		16,713	102,099	16,749	318,807	(3,043)	451,325	2,235

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

Note	Year ended 31 December		
	2012	2011	2010
	U.S. dollars in thousands		
CASH FLOWS FROM OPERATING ACTIVITIES:			
	104,774	47,363	69,692
	(13,563)	(11,788)	(7,626)
	<u>91,211</u>	<u>35,575</u>	<u>62,066</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
	(12,558)	(7,835)	(8,465)
	(2,284)	(2,564)	(2,326)
	195	642	163
5	(75,280)	(57,963)	-
5	-	(43,698)	-
5	-	3,850	-
	271	289	807
	<u>(89,656)</u>	<u>(107,279)</u>	<u>(9,821)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
	4,152	-	-
	(5,553)	(2,207)	(1,884)
	131,231	102,002	-
	(116,802)	(40,064)	(43,697)
	7,319	8,201	(2,147)
	(908)	(702)	(588)
	(3,029)	(3,380)	(2,733)
	<u>16,410</u>	<u>63,850</u>	<u>(51,049)</u>
INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND BANK CREDIT			
	17,965	(7,854)	1,196
	36,472	44,389	42,940
	(504)	(63)	253
BALANCE OF CASH, CASH EQUIVALENTS AND BANK CREDIT AT END OF YEAR			
	<u>53,933</u>	<u>36,472</u>	<u>44,389</u>

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

APPENDIX TO CONDENSED CONSOLIDATED STATEMENT CASH FLOWS

	Year ended December 31		
	2012	2011	2010
	U.S. dollars in thousands		
Cash generated from operations:			
Income before tax	65,608	52,866	59,786
Adjustments required to reflect the cash flows from operating activities:			
Depreciation and amortization	26,012	20,612	18,081
Recognition of compensation related to employee stock and option grants	1,553	1,108	979
Liability for employee rights upon retirement - net	(655)	225	221
Loss (gain) from sale and write-off of fixed assets and other assets	92	17	(508)
Erosion of loans	1,003	-	(142)
Interest paid - net	5,358	1,565	1,721
Loss from change in fair value of financial instruments	289	-	-
Income from bargain purchase	(1,729)	-	-
	<u>31,923</u>	<u>23,527</u>	<u>20,352</u>
Operating changes in working capital:			
Decrease (increase) in accounts receivable:			
Trade	(1,712)	(12,035)	(5,272)
Other	(206)	(3,046)	2,723
Decrease in other long-term receivables	136	-	-
Increase (decrease) in accounts payable:			
Trade	1,506	8,342	2,388
Other	3,772	(5,495)	(2,644)
(decrease) in other long-term payables	(379)	-	-
Decrease (increase) in inventories	4,126	(16,796)	(7,641)
	<u>7,243</u>	<u>(29,030)</u>	<u>(10,446)</u>
Cash flows from operating activities	<u><u>104,774</u></u>	<u><u>47,363</u></u>	<u><u>69,692</u></u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL

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

Frutarom Industries Ltd. (hereafter – the Company) is a global company, founded in 1933. The Company operates through an Israeli subsidiary (hereafter - Frutarom Ltd.) and the companies under its control. The Group has two main operations: the Flavors activity and the Fine Ingredients activity. The Group develops, manufactures, markets and sells flavors and fine ingredients used by food and beverage producers, pharma-nutraceutical, flavors and fragrances, and personal care and cosmetics products as well as other products. The Group sells its products in more than 140 countries to more than 14,000 clients. The Group has production facilities in Europe, North America, Latin America, Israel, and Asia (see also a list of subsidiaries in Note 23); The group has 31 research and development laboratories and it sells and markets its products principally through its 50 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 Heshaihs 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 shares are also listed through Global Depository Receipts on the official list of the London Stock Exchange (the “LSE”).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

a. Basis of Preparation:

- 1) The Group's financial statements as of 31 December 2012 and 2011 and for each of the three years in the period ended 31 December 2012, are in compliance with International Financial Reporting Standards (hereafter – IFRS) and interpretations to IFRS issued by the International Financial Reporting Interpretations Committee (IFRIC) and include the additional disclosure required under the Securities Regulations (Annual Financial Statements), 2010.

The significant accounting policies described below have been applied consistently in relation to all the years presented, unless otherwise stated.

The financial statements have been prepared under the historical cost convention, subject to adjustments in respect of revaluation of amounts funded for severance pay, financial assets at fair value through profit or loss presented at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in (Note 4). Actual results could differ significantly from those estimates and assumptions.

- 2) The period of the Group's operating cycle is 12 months.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- 3) The Group analyses the expenses recognized in the income statements using the classification method based on the functional category to which the expense belongs.

b. Principles of Consolidation

Subsidiaries are all entities over which the Group 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 immediately exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date the control ceases.

The group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary (hereafter – the acquired company) is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group.

The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination (except for certain exceptional items specified in IFRS 3 – "Business Combinations") (as amended), hereafter – IFRS 3R) are measured initially at their fair values at the acquisition date.

Any contingent consideration accrued to the Group as part of a business combination is measured at fair value at the date of business acquisition. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 "Financial Instruments" either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

The excess of the overall amount of the transferred consideration, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired and the liabilities assumed is recorded as goodwill –(see also f(1) below).

In cases where the net amount at acquisition date of the identifiable assets acquired and of the liabilities assumed exceeds the overall consideration that was transferred, the amount of non-controlling interest in the acquiree and the fair value as of date of acquisition of any previous equity interest in the acquiree as above, the difference is recognized directly in income or loss at date of acquisition.

Inter-company transactions, balances, including income, expenses and dividends on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognized in assets (in respect of inventory and fixed assets) are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

c. Translation of Foreign Currency Balances and Transactions:

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 that 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) Transactions and balances.

Foreign currency transactions in currencies different from the functional currency (hereafter – foreign currency) are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. 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 attributed to income or loss. Gains and losses arising from changes in exchange rates are presented in the statement of income among "financial expenses".

3) Translation of Financial Statement of 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 statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- (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: in which case income and expenses are translated at the rate on the dates of the transactions);
- (c) All resulting exchange differences are recognized among other comprehensive income.

On consolidation of the financial statements, exchange differences arising from the translation of the net investment in foreign operations and from loans and other currency instruments designated to serve as hedges to those investments are carried to other comprehensive income. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in other comprehensive income are recognized in the statement of income as part of the gain or loss on realization or sale.

Goodwill and fair value adjustments arising on the acquisition of foreign operations are treated as assets and liabilities of the foreign operations and translated at the closing rate. Exchange differences arising from translation as above are recognized in other comprehensive income.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

4) Information regarding exchange rates, based on data published by the Bank of Israel:

	<u>NIS</u>	<u>Pound Sterling</u>	<u>Euro</u>	<u>Swiss Franc</u>
Exchange rate as of December 31:				
2012	3.733	0.6184	0.7587	0.9158
2011	3.821	0.6485	0.7738	0.9407
2010	3.549	0.6461	0.7491	0.9369
Increase (decrease) of the dollar:				
during the year	%	%	%	%
2012	(2.3)	(4.6)	(1.9)	(2.7)
2011	7.7	0.4	3.3	0.4
2010	(6.0)	4.6	8.0	(9.0)
	<u>NIS</u>	<u>Pound Sterling</u>	<u>Euro</u>	<u>Swiss Franc</u>
Average exchange rate during				
the year:				
2012	3.856	0.6310	0.7782	0.9379
2011	3.578	0.6238	0.7188	0.8853
2010	3.733	0.6468	0.7537	1.0409
Increase (decrease) during of the	%	%	%	%
dollar during the year:				
2012	7.8	1.2	8.3	5.9
2011	(4.2)	(3.6)	(4.6)	(14.5)
2010	(5.1)	1.0	4.8	(4.1)

d. Segment Reporting (see also note 1)

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker in the Group, who is responsible for allocating resources and assessing performance of the operating segments.

The Group is organized and managed on a worldwide basis in two major operating activities: Flavors and the Fine Ingredients. Another operation is Trade and Marketing. Each activity constitutes a segment.

e. Property, Plant and Equipment:

The cost of a property, plant and equipment item is recognized as an assets only if: (a) it is probable that the future economic benefits associated with the item will flow to the Group and (b) the cost of the item can be measured reliably.

Property, plant and equipment is stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items and only when the two criteria mentioned above for recognition as assets are met.

The carrying amount of a replaced part is derecognized. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The cost of a property, plant and equipment item includes:

- (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, 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.

Depreciation and impairment of property, plant and equipment are recognized in the income statement.

Land owned by the Group is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives, as follows:

	<u>Percentage of</u> <u>Annual</u> <u>Depreciation</u>
Buildings and land under financial lease	2-4
Machinery and equipment	5-10
Vehicles and lifting equipment	15-20
Computers	20-33
Office furniture and equipment	6-20
Leasehold improvements	10

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

The asset's residual values, the depreciation method and useful lives are reviewed, and adjusted if appropriate, at least once a year.

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).

Gains or losses on disposals are determined by comparing proceeds with carrying amount. These are included in the statement of income among "other income - net".

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

f. Intangible Assets:

- 1) The overall amount of goodwill arising on acquisition of a subsidiary, associated company or a proportionately consolidated company represents the excess of the consideration transferred in respect of acquisition of a subsidiary over the net amount as of acquisition date of the identifiable assets acquired and the liabilities assumed. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'.
For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units (CGUs), or groups of CGUs that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and which is not larger than an operating segment (before aggregation) (see also g. below).
Impairment reviews of CGUs (or groups of CGUs) are undertaken annually and whenever there is any indication of impairment of CGU or group of CGUs. The carrying value of the CGU (or group of CGUs) is compared to the recoverable amount, which is the higher of value in use and the fair value less costs to sell.
Any impairment loss is allocated to write-down the carrying amount of the CGU's assets (or CGUs) in the following order: first, the write down of any goodwill allocated to a cash generating unit (or a group of CGUs); and afterwards to the remaining assets of the CGU or (group of CGUs) on a proportionate basis using the carrying amounts of each asset of the CGU (or group of CGUs).
Any impairment is recognized immediately as an expense and is not subsequently reversed.
- 2) Product formulas acquired as part of a business combination transaction are initially recorded at fair value and amortized on a straight-line basis over their useful lives (10-20 years); (mainly 20 years).
- 3) Customer relationships acquired in a business combination are measured at fair value at the acquisition date. The customer relations have a finite useful life and are carried at the recognized amount less accumulated amortization. Amortization is calculated using the straight-line method over the expected life of the customer relationship (7-10 years).
- 4) Separately acquired trademarks and licenses are shown at historical cost. Trademarks and licenses acquired in a business combination are recognized at fair value at the acquisition date. Trademarks and licenses have a definite useful life and are presented at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks over their estimated useful lives (20 years).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

5) Computer software

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software licenses. These costs are amortized over their estimated useful lives (3-5 years) using the straight line method.

Costs associated with maintaining computer software programmes are recognized 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 recognized 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 recognized as assets are amortized over their estimated useful lives using the straight line method (3-5 years) commencing the point in time when the asset is available for use, i.e., it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

6) Research and Development

Research expenses are accounted for as expenses as incurred. Cost incurred in respect of development projects (attributable to the design and testing of new or improved products) are recognized as intangible assets when the following criteria are met:

- It is technically feasible to complete the intangible assets so that it will be available for use;
- Management intends to complete the intangible asset and use it or sell it;
- There is an ability to use or sell the intangible asset;
- It can be demonstrated how the software product will generate probable future economic benefits;
- Adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and
- The expenditure attributable to the intangible asset during its development can be reliably measured.

Other development costs that do not meet the above criteria are recognized as cost as incurred. Development costs previously recognized as an expense are not recognized as an asset on a subsequent period. Capitalized development costs are presented as intangible assets and amortized as from the time the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management through its useful life in accordance with the straight-line method.

The Group fully recognized the R&D expenses as incurred.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

g. Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill or intangibles that are not yet available for use are not subject to amortization and are tested annually for impairment or more often if events have occurred or changes in circumstances indicate that the carrying amount may not be recoverable.

Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized 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 recognized in respect thereof at each statement of financial position date.

h. Government Grants

The group's research and development activities are supported in some of the countries in which it operates, and in Israel through the Israel Chief Scientist in the Ministry of Industry, Commerce and Labour (hereinafter - the OCS) by way of grants.

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are recognized in the income statement on a systematic basis over the periods in which the Group recognizes the relating costs (the costs that the grants are intended to compensate).

i. Financial assets:

1) Classification

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

Financial assets at fair value through profit or loss

This category includes two sub-categories: financial assets held for trade and financial assets designated at fair value through profit or loss. A financial asset is classified into this category if it was acquired principally for the purpose of selling in the short term or if was designated to this category by management. Assets in this category are classified as current assets if expected to be settled within 12 months, otherwise they are classified as non-current.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Receivable

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 statement of financial position date. These are classified as non-current assets. Receivables of the Group are classified as "accounts receivable" in the statement of financial position (Note 2k below).

2) Recognition and measurement

Regular purchases and sales of financial assets are recognized on the settlement date, which is the date on which the asset is delivered to the Group or delivered by the Group. Investments are initially recognized at fair value plus transaction costs for all financial assets not measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss, are initially recognized at fair value, and transaction costs are expensed in the statement of income. Financial assets are derecognized when the rights to receive cash flows there from have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are measured in subsequent periods at amortized cost using the effective interest method.

Gains or losses that stem from changes in the fair value of financial assets at fair value through profit or loss are presented in statement of income under "financial expenses - net" in the period in which they incurred. Dividend income from financial assets at fair value through profit or loss are recognized in statement of income under "other income - net" when the group is eligible to these payments.

3) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

4) Impairment of financial assets

Financial assets are presented at amortized cost.

The Group assesses at the each statement of financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Group uses to determine that there is objective evidence of an impairment of a financial assets or group of financial assets include observable: information that came to the attention of the Group in connection with the following loss events:

- Significant financial difficulty of the issuer or obligor;
- breach of contract, such as a default or delinquency in interest or principal payments;
- The Group, for economic or legal reasons relating to the borrower’s financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties;
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - (i) Adverse changes in the payment status of borrowers in the portfolio; or
 - (ii) National or local economic conditions that correlate with defaults on the assets in the portfolio.

Where objective evidence for impairment exists, the amount of the loss is measured as the difference between the asset’s carrying amount of the financial assets and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate (i.e., the effective interest rate computed for the asset upon initial recognition). The asset’s carrying amount is reduced and the amount of the loss is recognized in the statement of income.

If the amount of impairment loss in a subsequent period decreases, and this decrease may be attributed to an objective event that took place after the impairment was recognized (like improved credit rating of the borrower), reversing the previously recognized impairment loss is recorded in income statements.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

j. Inventories

Inventories are measured at the lower of cost or net realizable value. Raw material cost is determined using the "moving average" method.

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 capitalization of borrowing costs.

Net realizable value is the estimated selling price in the ordinary course of business, less the applicable and variable selling expenses.

k. Trade Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less they are classified as current assets. If not, they are classified as non-current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for doubtful accounts (hereafter – "provision for impairment" or "provision for doubtful accounts"). As to the way the impairment provision is determined and accounting treatment applied thereto subsequently see i4) below.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

l. Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, short-term bank deposits and other highly liquid short-term investments, the maturity of which does not exceed three months, bank overdrafts (repayable upon demand).

m. Share Capital

Ordinary shares of the Company are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown as a deduction, net of tax, from the proceeds of issuance.

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects are included in equity. Any difference between the cost of acquisition of the treasury shares and the consideration is carried to premium on shares.

n. Trade Payables

Trade payables are obligations of the Group to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are classified as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

o. Loans

Loans are recognized initially at their fair value, net of transaction costs incurred. Loans are subsequently measured at amortized cost; any difference between the consideration (net of transaction costs) and the redemption value is recognized in the statement of income over the period of the loan using the effective interest method.

Loans are classified as current liabilities unless the Group has an unconditional right to defer settlement of the loans for at least 12 months after the end of the reporting period, in which case they are classified as non-current liabilities.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

p. Current and Deferred Income Taxes:

The tax expenses for the reported years comprise of current and deferred tax. Tax is recognized in the statement of income.

The current income tax charge is calculated on basis of the tax laws enacted or substantially enacted at the statement of financial position date in the countries where the Company and the subsidiaries operate and generate taxable income. Management periodically evaluates tax issues related to its taxable income, based on relevant tax law, and makes provisions in accordance with the amounts payable to the Income Tax Authorities.

Deferred income tax is recognized using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Nevertheless, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affect neither accounting nor taxable income.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. The amount of deferred income taxes is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax is not calculated on temporary differences arising on investments in subsidiaries, as long as the timing of reversal of the differences is controlled by the Group and it is expected that no such reversal will take place in the foreseeable future.

The group recognizes deferred income tax assets in respect of temporary differences deductible for tax purposes only if it is expected that the temporary difference is reversed in the foreseeable future and to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax assets and liabilities are offset only if:

- There is a legally enforceable right to offset current tax assets against current tax liabilities; and
- When the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

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

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

q. Employee Benefits:

1) Pension Obligations

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered pension funds, determined by periodic actuarial calculations.

The Group has both defined benefit and defined contribution plans. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate and independent entity. The Group 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. A defined benefit plan is a pension plan that is not a defined contribution plan.

In accordance with the liability of Group companies to employees in respect of whom there is a defined benefit plan, the amounts that an employee will receive as severance pay on retirement depends on the number years of service and the employee's last salary. The severance pay liability recognized in the statement of financial position in respect of defined benefit plans is the present value of the defined benefit obligation at the statement of financial position date less the fair value of plan assets, with the addition of adjustments for unrecognized actuarial gains or losses and cost of unrecognized past services. The defined benefit obligation is calculated annually by actuary using the projected unit credit method.

The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows (after taking into account expected rates of pay raise). The assumption as to the discount rate is determined by external actuaries at the end of each year. In certain countries, the Group uses high quality corporate bonds to determine the rate of discount. In countries where there is no deep market for high quality corporate bonds, the discount rate is determined based on interest rates on government bonds denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the relevant liability.

The Group recognizes actuarial gains and losses arising from changes in actuarial assumptions and from the difference between assumptions made in the past and actual results, in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation. These gains or losses are charged or credited to the statement of income over the employees' expected average remaining working lives.

Past-service costs are recognized immediately in income, unless the changes to the 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 amortized on a straight-line basis over the vesting period.

Amounts funded for severance pay are measured at fair value; these amounts constitute "plan's assets" as defined in IAS 19 are therefore offset from the balance of liability for employee rights upon retirement for the purpose of presentation in the statement of financial position.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense commensurate with receipt from employees of the service in respect of which they are entitled for the contributions. Prepaid contributions are recognized as an asset to the extent that a refund of the excess amounts or a reduction in the future payments is available.

2) Vacation and Recreation Fees

Under the law in various countries, employee is entitled for vacation days and recreation fees (in Israel), both computed on an annual basis. The entitlement is based on the period of employment. The Group records a liability and an expense in respect of vacation and recreation fees, based on the benefit accumulated for each employee.

3) Bonus plans

Some of the Group's employees are entitled to receive an annual bonus in accordance with the bonuses plan determined by Group management for that year. The Group provides for payment of the bonus in accordance with meeting the targets of the plan and in accordance with Group's estimate as to the total amount of bonuses to be paid to employees.

r. Share-Based Compensation

The Group operates a number of equity-settled, share-based compensation plans, under which the Group receives services from employees as consideration for equity instruments (options) of Group companies. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense in the statement of income. The total amount to be expensed is determined by reference to the fair value of the options granted:

- considering the impact of any non-market vesting conditions (for example, remaining an employee of the entity over a specified time period); and
- excluding the impact of any non-vesting conditions.

Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the date of each statement of financial position, the Group revises its estimates of the number of options that are expected to vest based on the non-marketing vesting conditions. It recognizes the impact of the revision to original estimates, if any, in the statement of income, with a corresponding adjustment to equity.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

s. Provisions

Provisions are recognized when: the Group has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources will be required to settle the obligation and it is possible to prepare a reliable estimation of the amount of liability.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Provisions are measured at the present value of the cash flow expected to be required to settle the obligation using a pre-tax discount 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 recognized as interest expense.

t. Revenue Recognition Policy

Revenue is measured at the fair value of the consideration received or receivable for the sale of goods in the ordinary course of business. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group.

Revenues from sale of goods are recognized by the Group when all of the following conditions are met:

- (a) The significant risks and rewards of ownership of the goods have been transferred by the Group to the buyer;
- (b) The group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
- (c) The amount of revenues can be reliably measured.
- (d) It is probable that future economic benefit relating to the transaction will flow to the Group; and
- (e) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

The amount of revenue is not considered to be reliably measurable until all contingencies relating to the transaction have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

The products are occasionally sold with volume discounts; customers have a right to return faulty products. Sales are recorded based on the selling price, net of the estimated volume discounts and returns at the time of sale. Accumulated experience is used to estimate and provide for the discounts and returns. The volume discounts are assessed based on anticipated annual purchases. No element of financing is present as the sales are made with an average credit term, which is not higher than the market practice.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

u. Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Long term lease contracts for lease of land from the Israel Land Administration and from other countries are presented among fixed assets.

v. Earnings per Share

Basic:

The computation of basic earnings per share is based, as a general rule, on the profit attributable to holders of ordinary Company shares divided by the weighted average number of ordinary shares in issue during the period, excluding Company shares held by a subsidiary (Notes 2m).

Fully Diluted:

When calculating the diluted earnings per share, the Group adds to the average number of shares outstanding that was used to calculate the basic earnings per share also the weighted average of the number of shares to be issued assuming the all shares that have a potentially dilutive effect would be converted into shares. The potential shares, as above are only taken into account in cases where their effect is dilutive (reducing the earnings per share or increasing the loss per share).

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

	<u>Basic</u>	<u>Diluted</u>
	<u>In thousands</u>	<u>In thousands</u>
Year end 31 December:		
2012	57,344	57,613
2011	57,265	57,475
2010	57,262	57,458

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

w. Dividends

Dividend distribution to the Company's owners is recognized as a liability in the Group's statement of financial position on the date on which the dividends are approved by the Group's Board of Directors. Dividend paid includes an erosion component (from date of approval of dividend through date of payment thereof).

x. New International Financial Reporting Standards, Amendments to Standards and New interpretations

1) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the group:

a) IAS 19 – "Employee Benefits" (Amended 2011) (hereafter – the revised IAS 19)

The revised IAS 19 makes material changes to the recognition and measurement of defined benefit plans and termination benefit and to the disclosures for all employee benefits discussed in IAS 19. Set forth below is a summary of the key changes:

- The term "Actuarial gains and losses" was renamed "re-measurements" of the net defined liability (asset) (hereafter – "re-measurements"), which includes, in addition to actuarial gains and losses, certain components defined in the revised IAS 19. Re-measurements will be recognized immediately in other comprehensive income. Actuarial gains and losses will no longer be deferred using the "corridor" approach or recognized in profit or loss.
- Past-service costs will be recognized immediately in the period of a plan amendment; unvested benefits will no longer be spread over a future-service period.
- Annual expense for a funded benefit plan will include net interest expense or income, calculated by applying the discount rate to the net defined benefit asset or liability. This will replace the "finance charge" and "expected return on plan assets" currently applied under IAS 19.
- The distinction between short-term and long-term employee benefits for measurement purposes shall be based on when payment is expected, not when payment can be demanded.
- Any benefit that has a future-service obligation is not a termination benefit. A liability for a termination benefit is recognized when the entity can no longer withdraw the offer of the termination benefit or recognizes any related restructuring costs.
- There are additional disclosure requirements compared with IAS 19 in its present version.

The revised IAS 19 shall be applied for the first time by the company in the annual period beginning on 1 January 2013. The revised IAS 19 should be applied retrospectively, except for:

- a) An entity needs not to adjust the carrying amount of assets outside the scope of the revised IAS 19 for changes in employee benefits costs that were included in the carrying amount before the date of initial application of the revised IAS 19.
- b) Comparative information for some disclosures required in the revised IAS 19 about the sensitivity of the defined benefit obligation will not needed in financial statements for periods beginning before January 1, 2014.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The current accounting policy of the Group is to recognize actuarial gains or losses arising from changes in actuarial assumptions and from the difference between past assumptions and actual results, by the amount these gains or losses exceed the higher of 10% of the present value of the defined benefit liability and 10% of the fair value of plan assets. These gains or losses are carried to income over the expected average term of employment. Subsequent to application of the revised IAS 19, the Company shall not defer the recognition of re-measurements. The "re-measurements", as to be recomputed in accordance with the new provisions, shall be fully carried to other comprehensive income in the period in which they have arisen.

The first time application of the IAS 19 is not expected to have material effect on the Group's consolidated financial statements.

- b) Amendment to IAS 1- "Presentation of Financial Statements" (hereafter – Amendment to IAS 1). The amendment to IAS 1 changes the manner of disclosure of other comprehensive income items as part of the statement of comprehensive income.

Set forth below is a summary of the main amendments made to IAS 1:

- Items presented as part of the comprehensive income should be separated into two groups based on whether the items can be recycled in the future into profit or loss or not. Accordingly, items that cannot be reclassified into profit or loss in the future would be presented separately from items that can be recycled in the future into profit or loss.
- Entities electing to present comprehensive income items before the tax associated with these items will be required to present the tax effect separately for each of the two groups of the OCI items.
- The name of the statement of comprehensive income was changed to "statement of profit or loss and other comprehensive income". Nevertheless, IAS 1 allows entities to use other names.

The Group shall apply the amendment to IAS 1 for the first time to the annual reporting period commencing 1 January, 2013 with full retrospective application for all reported periods.

- c) The International Accounting Standard Board (hereinafter – "IASB") has issued in the current period and prior periods, several new standards and amendments to existing standards regarding consolidated financial statements, separate financial statements, disclosures of interests in other entities, fair value measurement, and offsetting financial assets and financial liabilities. Application of the standards is partially for annual periods beginning on January 1, 2013 and partially for annual periods beginning on January 1, 2014.

Early adoption is permitted.

The Groups believes that the new standards and amendments have no material effects on the results of operations and financial position of the Group.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT:

a. Financial Risk Management

1) Financial Risk Factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

Risk management is carried out under policies approved by the board of directors and senior management. These policies cover specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of non-derivative financial instruments, and investment of excess liquidity. Group policies also cover areas such as cash management and raising short and long-term debt.

The Group's business is characterized by considerable dispersion. The Group produces tens of thousands of products intended for tens of thousands of customers throughout the world, using tens of thousands 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.

a) Market Risks:

1) Foreign Exchange Risk

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 Group entities produce 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 financial assets held in foreign currencies. Since raw materials purchases for the Group's production are also conducted in various currencies, currency exposure is reduced.

The Group's subsidiaries manage this exposure locally. In addition, Group management monitors total global exposure of the Group.

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

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued):

The following table presents currency exposure in respect of balance denominated in currencies that are different than the functional currency of the reporting company and also the effect on income after taxes. At 31 December 2012, 2011 and 2010, if the U.S. dollar had weakened/strengthened by 1% against the currencies referred to below with all other variables unchanged:

	31 December 2012			
	U.S. dollars in thousands			
	NIS	Pound sterling	Euro	Swiss Franc
Financial asset(liabilities), net	(3,713)	16	(23,922)	(21)
Gain (loss) from change:				
Impact of 1% strengthening	29	*	189	*
Impact 1% weakening	(29)	*	(189)	*
	31 December 2011			
	U.S. dollars in thousands			
	NIS	Pound sterling	Euro	Swiss Franc
Financial asset(liabilities), net	9,643	(12)	7,494	62
Gain (loss) from change:				
Impact of 1% strengthening	(77)	*	(60)	*
Impact 1% weakening	77	*	60	*
	31 December 2010			
	U.S. dollars in thousands			
	NIS	Pound sterling	Euro	Swiss Franc
Financial asset/liabilities, net	2,094	(485)	11,326	628
Gain (loss) from change:				
Impact of 1% strengthening	(15)	4	(84)	(5)
Impact 1% weakening	15	(4)	84	5

* Represents amounts lower than \$1 thousand.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued):

2) Linkage of Monetary Balances

Monetary balances denominated in various currencies included in the Company's consolidated statement of financial position at 31 December 2012, are summarized below:

	<u>US dollar</u>	<u>NIS</u>	<u>Pound Sterling</u>	<u>Euro</u>	<u>Swiss Francs</u>	<u>Other currencies</u>	<u>Total</u>
	U.S. dollars in thousands						
Assets:							
Current assets:							
Cash and cash equivalents	18,157	1,008	2,953	19,046	3,533	9,236	53,933
Accounts receivable:							
Trade	18,663	10,644	12,695	42,429	7,030	15,293	106,754
Other	623	818	948	7,193	815	552	10,949
	<u>37,443</u>	<u>12,470</u>	<u>16,596</u>	<u>68,668</u>	<u>11,378</u>	<u>25,081</u>	<u>171,636</u>
Liabilities:							
Current liabilities:							
Short-term bank borrowings and loans	-	5,893	55	4,946	-	1,450	12,344
Accounts payable:							
Trade	14,183	2,841	3,350	20,639	4,829	2,395	48,237
Other	4,138	7,449	7,211	10,697	6,633	3,141	39,269
Non-current liabilities:							
Long-term loans	53,552	-	22,639	55,310	46,177	10	177,688
Other long-term payables	-	-				892	892
	<u>71,873</u>	<u>16,183</u>	<u>33,255</u>	<u>91,592</u>	<u>57,639</u>	<u>7,888</u>	<u>278,430</u>

Some of the balances are included in the statements of financial position of the consolidated companies in the UK, EU, Switzerland and Brazil whose functional currencies are the Pound Sterling, the Euro, the Swiss Franc and the Brazilian Real, respectively, and therefore do not involve exposure to income and loss.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued):

2) Linkage of Monetary Balances

Monetary balances denominated in various currencies included in the Company's consolidated statement of financial position at 31 December 2011, are summarized below:

	<u>US dollar</u>	<u>NIS</u>	<u>Pound Sterling</u>	<u>Euro</u>	<u>Swiss Francs</u>	<u>Other currencies</u>	<u>Total</u>
	U.S. dollars in thousands						
Assets:							
Current assets:							
Cash and cash equivalents	12,804	783	4,896	10,649	772	6,568	36,472
Accounts receivable:							
Trade	17,284	10,939	10,312	31,098	5,767	10,654	86,054
Other	476	1,712	542	2,391	1,317	552	6,990
	<u>30,564</u>	<u>13,434</u>	<u>15,750</u>	<u>44,138</u>	<u>7,856</u>	<u>17,774</u>	<u>129,516</u>
Liabilities:							
Current liabilities:							
Short-term bank borrowings and loans	-	-	-	4,761	-	-	4,761
Accounts payable:							
Trade	9,936	3,791	4,764	16,562	3,744	1,442	40,239
Other	19,698	-	5,309	5,091	7,065	1,281	38,444
Non-current liabilities:							
Long-term loans	49,403	-	34,073	53,391	-	18	136,885
	<u>79,037</u>	<u>3,791</u>	<u>44,146</u>	<u>79,805</u>	<u>10,809</u>	<u>2,741</u>	<u>220,329</u>

Some of the balances are included in the statements of financial position of the consolidated companies in the UK., EU and Switzerland whose functional currencies are the Pound Sterling, the Euro and the Swiss Franc, respectively, and therefore do not involve exposure to income and loss.

RUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued):

2) Cash Flow Risk Relating to Interest Rates

Since on a current basis the Group does not have significant assets bearing interest, its revenues and operating cash flow are not dependent on changes in interest rates.

The Group's interest rate risk arises from long-term and short-term borrowings. Borrowings received at variable rates expose the Group to cash flow interest rate risk.

The Group analyses its interest rate exposure. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Group calculates the impact on profit and loss of a defined interest rate shift. For each simulation, the same interest rate shift is used for all currencies. The scenarios are run only for liabilities that represent the major interest-bearing positions.

Based on the simulations performed, the impact on post tax profit for the year 2012 of a 0.1% shift in interest rate on loans would have been a change of \$ 124 thousand (2011 - \$ 79 thousand; 2010 - \$63 thousand).

b) 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 Group.

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.

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 counter-parties, continuously reviewing credit ratings, and limiting individual aggregate credit exposure accordingly.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued):

c) Liquidity Risk

Group entities must have sufficient availability of cash to meet their obligations. Each company is responsible for its 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 to monitoring of Group management.

The table presented below classifies the Group's financial liabilities into relevant maturity groupings based on the remaining period at 31 December 2012 to the contractual maturity date. Group entities do not have derivative financial liabilities. The amounts presented in the table represent the projected undiscounted cash flows.

	Less than 1 year	Between 1 and 3 years	Between 3 and 5 years
	U.S. dollars in thousands		
As of 31 December 2012:			
Borrowings	55,306	105,666	35,342
Accounts payable and accruals	87,506	940	-
	<u>142,812</u>	<u>106,606</u>	<u>35,342</u>
As of 31 December 2011:			
Borrowings	55,678	84,144	6,616
Accounts payable and accruals	78,683	-	-
	<u>134,361</u>	<u>84,144</u>	<u>6,616</u>

b. Capital management

Group's objective is to maintain, as possible, stable capital structure. In the opinion of Group's management its current capital structure is stable.

Consistent with others in the industry, the Group monitors capital, including others also, on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

The gearing ratios at 31 December 2012 and 2011 were as follows:

	2012	2011
	U.S. dollars in thousands	
Total borrowings (Note 9)	190,032	141,646
Less - cash and cash equivalents (Note 18)	(53,933)	(36,472)
Net debt	<u>136,099</u>	<u>105,174</u>
Total equity	<u>453,560</u>	<u>393,594</u>
Total capital	<u>589,659</u>	<u>498,768</u>
Gearing ratio	<u>23.1%</u>	<u>21.1%</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will by definition, not necessarily be 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.

a. Estimate of impairment of goodwill

The Group tests annually for impairment of goodwill, in accordance with the accounting policy states in note 2g. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates (Note 8).

b. Taxes on income and deferred taxes

The Group is subject to income taxes in a large number of countries. Judgment is required in determining the worldwide provision for income taxes. The group is involved in transactions and computations whose final tax liabilities cannot be determined with certainty in the normal course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due as a result of the tax audits. Where the final tax outcome of these matters, determined by tax authority is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax liabilities provisions in the period in which such determination is made.

The Group recognizes 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, 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.

c. Severance pay

The present value of the 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, inter alia, 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.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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 company uses the market of high-quality corporate bonds when this market available, when his not, government 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 severance pay liabilities, such as future payroll raise and retirement rates are partially based on existing market conditions on that time and on past experience.

d. Provisions

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

NOTE 5 – BUSINESS COMBINATIONS:

a. Acquisition of the operations of Rieber & Son ASA

On February 1, 2011 the Group acquired through a Norwegian subsidiary the industrial savory business of Rieber & Son ASA (hereafter – Rieber).

The Rieber operations include developing, producing and marketing savory flavoring solutions, including flavoring extracts, spice blends and other functional raw materials for the food industry, especially for the processed meat and seafood industry and the convenience food market. The Rieber operations has a broad customer base, including some leading food producers, especially in Scandinavia.

The cost of acquisition presented in the financial statements amounts to 24,540 thousands Norwegian Kroner (\$ 4,279 thousands); the acquisition was financed by self funds.

The cost of acquisition was fully allocated to intangible assets which were acquired based on their fair value at the time of the acquisition.

The product formulas and customer relations are amortized over economic life of 20 years and 10 years respectively. The goodwill is not amortized but rather tested at least once a year for impairment.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Towards the end of the fourth quarter of 2011, the Group completed the transfer of the production operations from Norway to Group's plants in Germany.

Set forth below are the assets and liabilities of Rieber at date of acquisition:

	<u>Fair value</u>
	<u>U.S. dollars</u>
	<u>In thousands</u>
Non-current assets -	
Intangible assets:	
Goodwill	3,540
Product formulas	373
Customer relations	366
	<u>4,279</u>

b. Acquisition of the operations of East Anglian Food Ingredients Ltd.:

On January 31, 2011, the Group acquired through a UK subsidiary the operations of the UK Company East Anglian Food Ingredients Ltd ("EAFI").

EAFI is engaged in development, production and marketing of savory flavoring solution, included flavoring extracts, spice blends and other functional raw materials for the food industry, focusing on convenience food, snacks and processed meat and fish. EAFI has a development, production and marketing site in the UK and a broad customer base.

The cost of acquisition presented in these financial statements amounts to \$ 4,834 thousands (£ 3,000 thousands); the acquisition was funded from self funds.

The cost of acquisition was fully allocated to acquire tangible assets, intangible assets and liabilities which were acquired based on their fair value at the time of the acquisition.

The intangible assets that were recognized include: product formulas in the total amount of £ 146 thousands (\$ 235 thousands), amortized over economic life of 20 years.

The acquired operations were merged to the existing operations of the subsidiary in U.K.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Assets and liabilities of EAFI at date of acquisition:

	Fair value
	U.S. dollars in thousands
Current assets:	
Accounts receivable:	
Trade	1,072
Inventory	1,909
Non-current assets:	
Fixed assets	2,438
Intangible assets	
Product formulas	235
Current liabilities :	
Accounts payable and accruals- trade	(693)
Deferred income taxes	(127)
	4,834

c. Acquisition of the savory business of Christian Hansen Italia S.P.A:

On 26 May 2011, the Group signed, through a UK subsidiary, an agreement to acquire assets and savory operations of Christian Hansen ITALIA S.p.a ("CH"). On 29 July 2011, the transaction was closed.

The Savory operation of CH (the "acquired operation") develops, produces and markets innovative savory solutions (the non-sweet taste spectrum) including flavors, seasoning compounds and functional ingredients for the food industry, with special emphasis on processed meat and convenience food applications. The acquired operation has an extensive customer base comprised mainly of leading Italian meat processors. The activity also enjoys export sales in Russia, Ukraine, Poland, the Czech Republic and France. Included among the assets purchased is a state-of-the-art, high-capacity plant located in Parma, Italy that will enable Frutarom to grow its activities and to take advantage of operational synergies with its existing savory activities in Europe. The Acquired Activity also has advanced R&D laboratories.

The Acquired operation is highly synergetic with the activity of the German companies Gewurzmuller and Nesse (acquired by Frutarom in 2007 and 2006 respectively), the German Savory Functional Systems activity of Chr. Hansen (acquired in 2009) along with the acquisitions of EAFI and Rieber completed in early 2011.

Net acquisition cost presented in these financial statements amounts to \$ 34,585 thousands (Total of €23,972 thousands and includes a payment of €25,000 thousands net of a refund of € 1,028 thousands received from the sellers in accordance with the adjustments mechanisms set in the acquisition agreement). The acquisition was financed using long-term bank credit.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

The Group merged the marketing, finance, R&D and purchasing activities of the acquired operations with its existing operations.

The cost of acquisition was fully allocated to acquire tangible assets, intangible assets and liabilities based on their fair value on the date of acquisition.

The intangible assets that were recognized include: product formulas in the total amount of €3,118 thousands (\$ 4,498 thousands), customer relations of €4,034 thousands (\$ 5,820 thousands) and goodwill of €6,604 thousands (\$ 9,527 thousands).

Assets and liabilities of CH at the date of acquisition:

	Fair value
	U.S. dollars in thousands
Current assets:	
Accounts receivable:	
Inventory	4,112
Non-current assets:	
Deferred income taxes	550
Property, plant and equipment	13,023
Intangible assets	
Goodwill	9,527
Product formulas	4,498
Customer relations	5,820
Current liabilities :	
Accounts payable and accruals	
Others	(868)
Non-current liabilities :	
Long-term loans	(1,845)
Retirement benefit obligations, net	(232)
	34,585

d. Acquisition of Aromco Ltd.:

On 19 August 2011, the Group acquired through a UK subsidiary 100% of share capital of a UK company – Aromco Ltd. ("Aromco").

Aromco develops, manufactures, and markets flavors for the food and beverage industry. Aromco is active mainly in the UK and in developing markets with high growth potential in Eastern Europe, Africa and Asia. Aromco operates a factory in Hertfordshire, England.

The Acquired operation is highly synergetic with Groups flavors activity. Aromco has many potential synergies with the Group's operations. The Group works to merge Aromco's activity into its UK and global operations, realizing synergies.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

The cost of acquisition presented in these financial statements amounts to \$24,614 thousand (£ 15,000 thousand). The acquisition was financed by a long-term bank loan.

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

The intangible assets that were recognized include: product formulas at \$3,354 thousand (£ 2,044 thousand), customer relations at \$4,750 thousand (£ 2,895 thousand) and goodwill at \$16,127 thousand (£ 9,828 thousand).

Assets and liabilities of Aromco at the date of acquisition:

	Fair value
	U.S. dollars in thousands
Current assets:	
Cash and cash equivalents	1,434
Accounts receivable:	
Trade	2,790
Inventory	1,058
Others	53
Non-current assets:	
Property, plant and equipment	530
Intangible assets:	
Product formulas	3,354
Customer relations	4,750
Goodwill	16,127
Current liabilities :	
Accounts payable and accruals :	
Trade	(819)
Others	(2,456)
Deferred income taxes	(2,207)
	24,614

e. Acquisition of Flavor Systems International Inc.:

On September 13, 2011, the Group signed through a US subsidiary an agreement to acquire 100% of the share capital of a US company – Flavor Systems International Inc. ("Flavor Systems"). The transaction was completed on October 3, 2011.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Flavor Systems is engaged in the development, production and marketing of sweet and savory flavors to the food and beverages markets. Flavor Systems owns a modern plant and R&D laboratories, located in Cincinnati, Ohio. The acquisition also includes a new and advanced production site. The site will enable expansion into market segments where the group is not active presently, such as the growing market for flavored coffee and shakes sold at convenience stores and large food chain stores in the US. In addition, through this acquisition, the group gains access for the first time to the US savory flavors market.

The operations of the acquired company are synergistic to the operations of Flavor Specialties in Corona, California, which was purchased by the group in 2009.

The final price of the transaction was determined in accordance with an agreed mechanism related to future considerations, based on a 6.5 multiplier of EBITDA exceeding \$5 million gained by the operation of Flavor Systems during the 12 months starting on October 1, 2011 and ending on September 30, 2012 ("the target EBITDA"), up to a ceiling of \$10 million. In addition, in the event that the target EBITDA during that period is less than \$5 million, the sellers will repay up to \$6 million to Frutarom. Therefore, the consideration for the acquisition may range from \$28.8 million to \$45.3 million, according to this mechanism. In addition, the Company paid \$6.5 million for real-estate assets that are under the ownership of other companies owned by the shareholders of Flavor Systems. In accordance with the above-mentioned mechanism, the Group paid an additional amount of \$10 million.

The cost of acquisition amounts to \$35,262 thousands, with the addition of a contingent consideration of \$10,000 thousands in accordance with the adjustment mechanism set in the acquisition agreement; the two amounts total \$45,055 thousands. The acquisition was financed using long-term bank credit.

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

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Assets and liabilities of Flavor Systems at the date of acquisition:

	<u>Fair value</u> <u>U.S. dollars in</u> <u>thousands</u>
Current assets:	
Cash and cash equivalents	4
Accounts receivable:	
Trade	1,378
Inventory	2,120
Others	153
Non-current assets:	
Property, plant and equipment	10,871
Intangible assets:	
Goodwill	29,077
Product formulas	6,886
Customer relations	7,247
Current liabilities :	
Accounts payable	(1,101)
Short term bank credit	(195)
Others creditors	(729)
Deferred income taxes	(288)
Long-term loans	(10,368)
	<u>44,055</u>

f. Acquisition of Savoury Flavours

On January 4, 2012, Frutarom signed, through a UK subsidiary, an agreement for the purchase of 100% of the share capital of UK company Savoury Flavours (Holding) Limited and its subsidiaries (hereafter – "Savoury Flavours") in consideration for \$ 5.8 million (£ 3.8 million) and an additional consideration that in the opinion of the Company shall not exceed £0.3 million. In addition, the Company paid £0.1 million due to working capital adjustment as of the day of the acquisition.

Founded in 1999, Savoury Flavours develops, manufactures, and markets savory taste solutions, including mainly flavors, seasoning compounds, marinades, and sauces, specializing in snacks and convenience foods. Savoury Flavours has a development, manufacturing, and marketing site in the United Kingdom, and a wide customer base including food manufacturers and private label manufacturers in the U.K. and in emerging markets.

In the 12 months ended December 31, 2011, Savoury Flavours' sales turnover total amounted \$7.1 million.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Savoury Flavours' production site is located close to EAFI's production site (savory operation that was acquired in 2011). Frutarom merged and combined the two operations as well as with integrated those operations into Frutarom's savory operations in the UK and all over the world and will continue so in the coming months. The geographic proximity, along with the two companies' complementary product portfolios and technologies, will allow business synergies between Savoury Flavours' and Frutarom's fast growing activities in savory foods categories in the UK and worldwide.

The transaction was financed using bank credit and was completed on the day the said agreement was signed.

The cost of acquisition was allocated to tangible assets, intangible assets and liabilities which were acquired based on their fair value at the time of the acquisition. The intangible assets recognized include product formulas in the total amount of £ 837 thousands (\$ 1,291 thousands), customer relations in the total amount of £ 336 thousands (\$ 518 thousands) and goodwill in the total amount of £ 2,492 thousands (\$ 3,843 thousands).

Assets and liabilities of Savoury Flavours at the date of acquisition:

	Fair value
	U.S. dollars in thousands
Current assets:	
Accounts receivable:	
Trade	1,078
Inventory	990
Others	123
Non-current assets:	
Property, plant and equipment	170
Intangible assets:	
Product formula	1,291
Customer relations	518
Goodwill	3,843
Current liabilities :	
Accounts payable:	
Trade	(526)
Other	(865)
Non-current liabilities:	
Deferred income taxes	(447)
Other	(363)
	5,812

The acquired operations generated revenue of \$ 7,694 thousands and net income of \$733 thousands (after acquisition and finance costs), for the period from the acquisition date through December 31, 2012.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

f. Acquisition of Etol

In the first quarter of 2012, Frutarom purchased, through a Swiss subsidiary, app. 98% of the share capital of the public Slovenian company Etol in consideration for €34.6 million. On May 8, 2012, Etol was delisted from the Slovenian Stock Exchange. On June 5, 2012 Frutarom has completed the acquisition of the remaining shares of Etol, So that the total cost of acquisition of all of Etol's shares amounted to approximately €35.4 million (\$ 45.7 million).

Together with its subsidiaries, Etol, founded in 1924, develops, manufactures and markets sweet and savory flavors, focusing on natural flavor products for the food and beverage industry. Etol also has great experience in development of fruit based flavors and products and Food Systems, specializing on local fruits of the region as well as extensive activating in the growing area of bases for beverages that plans to further invest in order to substantially expand its global activity.

Etol also has trade and marketing activities for products it does not manufacture, targeted for European countries, which will be integrated into the trade and marketing sector, together with the trade and marketing sector in Israel. Trade and marketing activities are not counted among Frutarom's core activities.

In the twelve months ended December 31, 2011, Etol group's consolidated sales turnover amounted to €51.3 million (\$ 71.4 million).

Etol has a sophisticated and innovative plant located on some 70 dunam of land east of Ljubljana in Slovenia. Etol's products are sold to a wide customer base in Central and Eastern Europe and in emerging markets, including Russia, Poland, the Ukraine, Croatia, Serbia, Belarus, Hungary, Slovakia, Macedonia, the Czech Republic, Kazakhstan, Turkey and other emerging markets as well as developed countries such as the UK, Switzerland and Germany. Among Etol's customers, leading food and beverage manufacturers in the countries it operates, including large multi-national food companies. The activities of Etol are synergetic with Frutarom's activities.

Frutarom is acting to integrate Etol's research and development, marketing and sales, logistics, procurement and manufacture with its own global operations, creating operational synergies and cross-selling.

The consideration paid in cash amounted to \$ 45,734 thousands (€35,387 thousands) and was fully funded by long-term bank credit.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

The cost of acquisition was allocated to tangible assets, intangible assets and liabilities which were acquired based on their fair value at the time of the acquisition. The intangible assets recognized include product formulas in the total amount of €2,472 thousands (\$ 3,195 thousands), customer relations in the total amount of €1,267 thousands (\$ 1,637 thousands) and gain on a bargain purchase in the total amount of €1,338 thousands (\$ 1,729 thousands). The product formulas and customer relations are amortized over an economic useful life of 20 years and 10 years, respectively. The gain on a bargain purchase was recorded as a one-off income in the statement of income.

Assets and liabilities of Etol at the date of acquisition:

	Fair value
	U.S. dollars in thousands
Current assets:	
Cash and cash equivalents	1,068
Accounts receivable:	
Trade	16,092
Inventory	10,435
Others	4,925
Non-current assets:	
Property, plant and equipment	38,647
Software	1,752
Other	629
Intangible assets:	
Product formula	3,195
Customer relations	1,637
Gain on a bargain purchase	(1,729)
Current liabilities :	
Accounts payable -	
Trade	(4,049)
Other	(2,988)
Deferred income taxes	(534)
Non-current liabilities	
Employee benefits	(2,144)
Long-term loans	(21,202)
	45,734

The acquired operations generated revenue of \$ 67,193 thousands and net income of \$6,126 thousands (net of acquisition expenses and finance expenses relating to the acquisition) for the period from the acquisition date through December 31, 2012.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

g. Acquisition of Mylner Industria E Comercio Ltda

On February 6, 2012 Frutarom signed, through a subsidiary, an agreement for the acquisition of 100% of the share capital of the Brazilian company Mylner Industria E Comercio (hereafter – “Mylner”) and its parent company Vila Osorio Participacoes in consideration for \$ 15.7 million (27.1 Brazilian real). Frutarom also paid a total of 4.4 million Brazilian reais for the cash balance of Mylner out of which a total of 3.1 Brazilian real (capitalized value – 3 million Brazilian real) has not yet been paid and used as security for the seller's indemnification liability in accordance with the purchase agreement, to be realized in installments over 3 years.

Mylnar, founded in 1974, develops, produces and markets sweet flavors for beverages and baked goods, and natural flavor products. Mylner has a modern development, production, and marketing site in the area of Sao Paulo, Brazil, including land for future expansion, and employs some 70 workers. Mylner’s wide customer base includes leading food manufacturers mainly in Brazil, and in other developing countries in Latin America.

In 2011, Mylner sales turnover amounted to \$ 11.4 million (app. 19 million Brazilian real). The transaction was financed by a long term bank credit and was completed on the date of signing the agreement.

The cost of acquisition was allocated to tangible assets, intangible assets and liabilities which were acquired based on their fair value at the time of the acquisition. The intangible assets recognized include product formulas in the total amount of 2,948 thousands Brazilian real (\$ 1,685 thousands), customer relations in the total amount of 2,707 thousands Brazilian real (\$ 1,547 thousands) and goodwill in the total amount of 19,976 thousands Brazilian real (\$ 11,415 thousands). The product formulas and customer relations are amortized over an economic useful life of 20 years and 10 years, respectively.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Assets and liabilities of Mylner at date of acquisition:

	<u>Fair value</u> <u>U.S. dollars in</u> <u>thousands</u>
Current assets:	
Cash and cash equivalents	2,542
Accounts receivable:	
Trade	680
Inventory	977
Non-current assets:	
Fixed assets	1,359
Intangible assets:	
Product formula	1,685
Customer relations	1,547
Goodwill	11,415
Current liabilities :	
Trade	(578)
Other	(1,078)
Short-term credit	(5)
Deferred income tax	(1,063)
Non-current liabilities	
Other	(1,025)
	<u><u>16,456</u></u>

The acquired operations generated revenue of \$8,546 thousands and net income of \$ 177 thousands (net of acquisition expenses in the amount of \$370 thousands and finance expenses relating to the acquisition) for the period from the acquisition date through December 31, 2012.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – SEGMENT REPORTING

a. Operating Segments

For management purposes, the Group is organized on a worldwide basis into two major operating activities: Flavour and Fine Ingredients. Another operating activity is Trade and Marketing (each operation is considered to be a reportable segment (Note 2d). Results of operating segments are measured based on operating income.

Frutarom's Flavors Activity develops, produces, markets and sells high-quality, value added sweet and savory flavors used mainly by manufacturers of food and beverages and other consumer products including flavors and Food Systems products (products combining fruits, vegetables and/or other natural ingredients, including sweet and non-sweet flavors. These products are used in a wide variety of food products such as dairy, ice cream, sweets, salty baked products, convenience food and other prepared meals). As part of Frutarom's Specialty Fine Ingredients Activity develops, produces, markets and sells natural flavor extracts, natural functional food ingredients, natural pharma/nutraceutical extracts, specialty essential oils, citrus products, aroma chemicals, and natural gums.

The Fine Ingredients are sold principally to the food and beverage, flavor and fragrance, pharmaceutical and personal care industries. The Trade and Marketing activity focuses in trade and marketing of raw materials produced by third parties. These operations are the basis on which the Group reports its primary segment information.

Segment data provided to the chief operating decision-maker in respect of the reported segments for the year ended:

31 December, 2012 is as follows:

	Flavors operations	Fine ingredients operations	Trade and marketing operations	Eliminations	Total Consolidated
	U.S. dollars in thousands				
Income statement data:					
Sales – net:					
Unaffiliated customers	457,341	138,318	22,342	-	618,001
Intersegment	-	2,445	-	(2,445)	-
Total sales and other operating income	<u>457,341</u>	<u>140,763</u>	<u>22,342</u>	<u>(2,445)</u>	<u>618,001</u>
Segment results	<u>59,477</u>	<u>12,378</u>	<u>1,000</u>	<u>(7)</u>	72,848
Financial expenses – net					7,240
Taxes on income					13,628
Net income					<u>51,980</u>

31 December, 2011 is as follows:

	Flavors operations	Fine ingredients operations	Trade and marketing operations	Eliminations	Total Consolidated
	U.S. dollars in thousands				
Income statement data:					
Sales – net:					
Unaffiliated customers	369,894	142,176	6,373	-	518,443
Intersegment	-	2,832	-	(2,832)	-
Total sales and other operating income	<u>369,894</u>	<u>145,008</u>	<u>6,373</u>	<u>(2,832)</u>	<u>518,443</u>
Segment results	<u>46,811</u>	<u>11,745</u>	<u>353</u>	<u>(245)</u>	58,664
Financial expenses – net					5,798
Taxes on income					10,835
Net income					<u>42,031</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – SEGMENT REPORTING (continued):

31 December 2010 is as follows:

	Flavors operations	Fine ingredients operations	Trade and marketing operations	Eliminations	Total Consolidated
	U.S. dollars in thousands				
Income statement data:					
Sales – net:					
Unaffiliated customers	306,374	139,267	5,425	-	451,066
Intersegment	-	2,273	-	(2,273)	-
Total sales and other operating income	<u>306,374</u>	<u>141,540</u>	<u>5,425</u>	<u>(2,273)</u>	<u>451,066</u>
Segment results	<u>46,268</u>	<u>16,813</u>	<u>124</u>	<u>(223)</u>	<u>62,982</u>
Financial expenses - net					3,196
Taxes on income					15,675
Net income					<u>44,111</u>

b. Additional information:

1) Geographical Segment information

The Group has operating production facilities in Europe, North America, Israel and Asia. In addition, the Group has 31 research and development laboratories and sells and markets its products principally through its 50 sales and marketing offices.

2) Sales by Destination Based on End Customer Location

Following are data regarding the distribution of the Company's sales by:

	Year ended 31 December		
	2012	2011	2010
	U.S. dollars in thousands		
EMEA*	428,326	359,238	306,790
America**	91,065	60,257	55,970
Asia and the Far East	57,539	55,053	48,710
Israel***	41,071	43,895	39,596
	<u>618,001</u>	<u>518,443</u>	<u>451,066</u>
***Including trade and marketing operations	<u>4,720</u>	<u>6,373</u>	<u>5,425</u>

* Europe, Africa and the middle east (excluding Israel).

Sales in Germany amounted to \$ 74,085 thousands, \$ 84,219 thousands and \$ 76,946 thousands in 2012, 2011 and 2010, respectively.

** In this report America includes sales in the USA amounting to \$ 65,867 thousands, \$ 45,191 thousands and \$ 41,183 thousands in the years 2012, 2011 and 2010, respectively.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT

a. Composition of assets, grouped by major classifications and changes therein in 2012 is as follows:

	Cost				Balance at end of year	Accumulated depreciation				Balance at end of year	Depreciated balance 31 December 2012
	Balance at beginning of year	Additions during the year	Retirements during the year	Other*		Balance at beginning of year	Additions during the year	Retirements during the year	Other*		
	U.S. dollars in thousands					U.S. dollars in thousands					
Land and buildings	84,991	2,951	(3)	64,804	152,743	14,277	3,607	-	25,999	43,883	108,860
Machinery and equipment	132,938	7,330	(538)	37,357	177,087	84,964	8,727	(315)	30,770	124,146	52,941
Vehicles and lifting Equipment	4,969	973	(545)	1,208	6,605	3,156	822	(450)	688	4,216	2,389
Furniture and office equipment (including computers)	35,626	979	(776)	4,867	40,696	16,900	1,571	(764)	3,834	21,541	19,155
Leasehold improvements	12,795	325	(12)	281	13,389	6,567	903	(8)	448	7,910	5,479
	<u>271,319</u>	<u>12,558</u>	<u>(1,874)</u>	<u>108,517</u>	<u>390,520</u>	<u>125,864</u>	<u>15,630</u>	<u>(1,537)</u>	<u>61,739</u>	<u>201,696</u>	<u>188,824</u>

* Arising from acquisition of consolidated companies and operations and from translation of foreign currency financial statements of consolidated subsidiaries.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Composition of assets, grouped by major classifications and changes therein in 2011 is as follows:

	Cost				Accumulated depreciation				Depreciated balance 31 December 2011		
	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
	U.S. dollars in thousands				U.S. dollars in thousands						
Land and buildings	62,427	1,309	(14)	21,269	84,991	10,698	2,172	-	1,407	14,277	70,714
Machinery and equipment	123,141	4,246	(423)	5,974	132,938	75,202	8,088	(301)	1,975	84,964	47,974
Vehicles and lifting Equipment	4,413	596	(451)	411	4,969	2,593	687	(291)	167	3,156	1,813
Furniture and office equipment (including computers)	33,822	1,242	(343)	905	35,626	15,467	1,206	(333)	560	16,900	18,726
Leasehold improvements	12,166	442	-	187	12,795	5,887	634	-	46	6,567	6,228
	<u>235,969</u>	<u>7,835</u>	<u>(1,231)</u>	<u>28,746</u>	<u>271,319</u>	<u>109,847</u>	<u>12,787</u>	<u>(925)</u>	<u>4,155</u>	<u>125,864</u>	<u>145,455</u>

* Arising from acquisition of consolidated companies and operations and from translation of foreign currency financial statements of consolidated subsidiaries.

b. Lease of 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 December 31, 2012, in respect of the said lands, amount to \$ 1,141 thousands (2011- \$ 1,173 thousand). 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) 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 December 31, 2012, in respect of the said land, amount to \$ 175 thousand (2011 - \$ 183 thousand).
- 3) In 2012 and 2011, a subsidiary in China acquired “Land Use Rights” on land in China for the purpose of erecting a plant in China. The rights are for a period of 50 years. The cost presented in these financial statements is \$ 1,211 thousands.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 – INTANGIBLE ASSETS:

	<u>Original amount</u>		<u>Amortized balance</u>	
	<u>31 December</u>		<u>31 December</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Know-how and product formulas	56,271	48,596	41,782	37,611
Goodwill	198,752	180,656	197,493	179,428
Customer relations	46,210	41,765	29,807	29,982
Trademarks	230	219	99	105
Computer software	25,264	17,877	10,017	8,584
	<u>326,727</u>	<u>289,113</u>	<u>279,198</u>	<u>255,710</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 – INTANGIBLE ASSETS (continued):

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

	<u>Computer software</u>	<u>Know- how and Product formulas</u>	<u>Goodwill*</u>	<u>Customer relations</u>	<u>Trademarks</u>	<u>Total</u>
	U.S. dollars in thousands					
Balance as of 1 January 2011 – net	8,668	25,427	126,879	16,046	116	177,136
Acquisitions	2,564	-	-	-	-	2,564
Adjustment arising from acquisition of consolidated companies and operations	-	15,346	57,796	18,183	-	91,325
Exchange differences	(180)	(958)	(5,247)	(1,105)	-	(7,490)
Annual amortization charge (Note 2f)	(2,468)	(2,204)	-	(3,142)	(11)	(7,825)
Closing net book amount	<u>8,584</u>	<u>37,611</u>	<u>179,428</u>	<u>29,982</u>	<u>105</u>	<u>255,710</u>
Changes in the year ended 31 December 2012:						
Acquisitions	2,284	-	-	-	-	2,284
Retirements during the year	(26)	-	-	-	-	(26)
Adjustment arising from acquisition of consolidated companies	1,752	6,921	15,733	3,702	-	28,108
Exchange differences	247	510	2,332	410	5	3,504
Annual amortization charge (Note 2f)	(2,824)	(3,260)	-	(4,287)	(11)	(10,382)
Closing net book amount	<u>10,017</u>	<u>41,782</u>	<u>197,493</u>	<u>29,807</u>	<u>99</u>	<u>279,198</u>

* Goodwill as of 31 December 2012 is allocated to the Flavor segment in the U.K., Germany, Israel, Norway, Italy, the USA and Brazil and to the Fine Ingredients segment in Belgium, USA and the UK.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 – INTANGIBLE ASSETS (continued):

Impairment test for goodwill

The goodwill recorded in the Group's books of accounts arises from acquisitions of consolidated companies and operations carried out by the Group over the years, the goodwill is allocated to the cash-generating units of the Group in accordance with the unit and the business segment from which it arises.

Set forth below is a summary of goodwill allocation between the various cash-generating units:

	31 December	
	2012	2011
	U.S. dollars in thousands	
Cash-generating unit 1	100,062	97,915
Cash-generating unit 2	36,120	35,645
Cash-generating unit 3	15,893	15,154
Cash-generating unit 4	11,053	10,540
Cash-generating unit 5	9,748	-
Cash-generating unit 6	6,705	6,574
Cash-generating unit 7	6,066	5,784
Cash-generating unit 8	4,030	-
Cash-generating unit 9	2,699	2,699
Cash-generating unit 10	2,619	2,619
Cash-generating unit 11	2,498	2,498
Total	197,493	179,428

The changes in goodwill between the years are due to acquisitions of new companies/operations, changes in the exchange rate of the currency of the foreign operation compared with the dollar as explained in Note 5.

The recoverable amount of a cash-generating unit is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on past results of the unit, its budget for the following year and the projection for future years, cash flows beyond the five-year period are extrapolated using a grow rate of 2%, which does not exceed the long-term growth rate for the food business, in which the Group operates.

The average discount rate taken into account in the calculation is 15.8% before taxes.

Group management determined profit rates based on past performance and its expectations for developments in respect of each of the cash-generating units.

The recoverable amount of cash-generating unit 1 and 2 was calculated and examined by an external assessor, whereas the recoverable amount of the remaining cash-generating units was calculated and examined by Group management.

The results of the above analysis show that the value of goodwill of each of the said cash-generating units has not been impaired, both in the basic calculations and in calculations performed for the purpose of sensitivity test.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9 – BORROWINGS

	December 31	
	2012	2011
	U.S. dollars in thousands	
Non current borrowings	137,836	88,947
Current borrowings:		
Current maturities of long-term loans	39,852	47,938
Bank borrowings	12,344	4,761
	<u>52,196</u>	<u>52,699</u>
Total borrowings	<u>190,032</u>	<u>141,646</u>

Bank borrowings as of December 31, 2012 mature until 2016 and bears average interest of 2% according to the loan terms and Libor rates as of 31 December, 2012

The exposure of the Group's cash flows to interest rate changes is dependent at the rate of Libor-Euro, Libor-Dollar, Libor-Swiss franc and Libor-Pound Sterling and it is updated on a quarterly semi-annual basis.

Due to the above, the fair value of current and non-current borrowings equals their carrying amount, as the impact of discounting is not significant. The fair values are based on cash flows discounted the borrowings' discount rate.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

	Weighted average interest rates*	31 December	
		2012	2011
		U.S. dollars in thousands	
Pound sterling	2.86%	22,694	34,073
Dollars	2.09%	53,552	49,403
Euro	2.05%	60,256	58,152
Swiss Franc	1.21%	46,177	-
NIS	3.1%	5,893	-
Other currencies	8.09%	1,460	18
		<u>190,032</u>	<u>141,646</u>

* Interest rates as of 31 December, 2012

The long term liabilities (net of current maturities) mature in the following years after the balance sheet dates:

	2012	2011
	U.S. dollars in thousands	
Second year	33,736	65,462
Third year	68,987	16,941
Fourth year	35,113	6,544
	<u>137,836</u>	<u>88,947</u>

The Group has several loans, in respect of which it has undertaken to meet certain financial covenants (see note 14). As of 31 December 2012, the Group meets all the required financial covenants.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 – LIABILITY FOR EMPLOYEE RIGHTS UPON RETIREMENT:

- a. Labour laws and agreements in Israel and abroad require the Company and its consolidated companies to pay severance pay and/or pensions to employees dismissed or retiring from their employ in certain other circumstances. Group 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, inter alia, 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 been transferred to these subsidiaries as part of the acquisition of subsidiaries in 2003 and 2007, respectively. The consolidated companies 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 liability for pension payments and the assets of the pension fund, as detailed in d. below.

Amounts charged to income statement in respect of defined benefit plan are as follows:

	Year ended December 31		
	2012	2011	2010
	U.S. dollars in thousands		
Current service cost	1,484	1,528	1,310
Interest cost	1,388	1,496	1,522
Actual return on plan assets – U.S. subsidiary	(158)	(171)	(160)
Expected return on plan assets – Swiss and German consolidated companies	(789)	(852)	(832)
Net actuarial losses (gains) recognized during the year	(819)	143	40
Total included in expenses	<u>1,106</u>	<u>2,144</u>	<u>1,880</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 – LIABILITY FOR EMPLOYEE RIGHTS UPON RETIREMENT (continued):

Changes in net liability for employee rights upon retirement recorded in the statement of financial position in respect of post employment defined benefit plans, were as follows:

	Year ended December 31	
	2012	2011
	U.S. dollars in thousands	
At 1 January	11,359	11,242
Total expenses included in employees' remuneration	1,106	2,144
Adjustments due to acquisition of consolidated companies	2,144	-
Benefits paid	(1,421)	(1,899)
Currency translation effects and others	(61)	(128)
At 31 December*	13,127	11,359

The following amounts were recognized in the statement of financial position for post-employment defined benefit plans:

	December 31	
	2012	2011
	U.S. dollars in thousands	
Present value of obligations arising from fully or partially funded plans	57,644	48,623
Fair value of plan assets	(33,315)	(32,480)
Excess of the present value of funded liability over plan assets	24,329	16,143
Unrecognised actuarial losses	(11,202)	(4,784)
Balance of liability recognized in the statement of financial position*	13,127	11,359

Amounts recognized in the statement of financial position for post-employment defined benefit plans are predominantly non-current and are reported as non-current liabilities.

*As of 31 December 2012, the balance includes a debit balance of \$ 102 thousands presented among Non-current assets as other.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 – LIABILITY FOR EMPLOYEE RIGHTS UPON RETIREMENT (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		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
Discount rates	4.15%	5.15%	5.7%	3.03%	4.77%	4.85%	1.8%	2.3%	2.75%
Projected rates of payroll raise				1.16%	1.16%	1.16%	2.0%	2.0%	2.5%
Expected rates of return on plan assets	7.0%	7.25%	7.25%	4.81%	5.03%	5.64%	2.0%	2.5%	2.75%

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

1) Lease Commitments:

Some of the Group's premises, warehouses, sites and vehicles in the U.K., Germany, Belgium and Israel occupied by the Group are rented under various operating lease agreements. The lease agreements for the premises will expire on various dates between 2013 and 2018.

Minimum lease commitments of the Group under the above leases, at rates in effect on 31 December 2012, are as follows:

	\$ in thousands
Year ending 31 December:	
2013	5,105
2014	2,409
2015	1,631
2016	1,540
2017	1,363
2018	551
	<u>12,599</u>

Rental expenses totaled \$ 5,818 thousand, \$ 4,673 thousand and \$ 4,528 thousand, in the years ended 31 December 2012, 2011 and 2010, respectively.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES (continued):

2) Royalty Commitments:

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 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 2012 is \$1,202 thousand.

In 2012, Frutarom Ltd. was of the opinion that it is more likely than not that it would not be required to refund Chief Scientist grants in the total amount \$52 thousand (2011 - \$158 thousand); therefore it carried this amount to income.

b. Contingent Liabilities:

Legal Procedures against the Company and consolidated companies:

- (a) A number of 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 all the defendants and the third parties); due to the period during which effluents were discharged by the Group compared with the other defendants.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES (continued):

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 several claims (that were joined), the amount of which was not specified, and which were filed by 92 former soldiers (or their inheritors) against Haifa Chemicals Ltd. ("HCL") (twenty of which were rejected in preliminary stages) and against three other defendants for alleged bodily injury caused to the plaintiffs while the defendants polluted the Kishon River in the course of their military service, 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 third parties will bear the compensation to be paid to the plaintiffs, since according to the claimants, those third parties were responsible for the damages.
 - (2) As part of a claim, the amount of which was not specified, and which was filed by 17 former IDF soldiers (or their heirs), four of the ten defendants sent third party notices to the Company and to other parties. In these notices, the defendants demand that the third parties shall compensate the claimants, should the Court rule the payment of such compensation.
 - (3) As part of a claim, the amount of which was not specified, and which was filed by 41 fishermen 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 Company 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 third parties will bear part of the compensation to be paid to the fishermen and/or indemnify the defendants for payment of the said compensation.
- (b) A claim was lodged against the Company in the Haifa District Court in August 2007, for a smell hazard that was allegedly caused to the claimant by the company's Haifa plant (hereafter- the claim). At the same time an application was submitted for approval of the claim as a class action (hereafter – application for approval). The claimants claim that the smell hazards caused by the plant have damaged the individual's autonomy and his/her right to breathe clean air, to the extent that their quality of life was damaged. The amount of damages claimed as specified in the application as above was NIS 225 million (\$ 59 million).

On 19 February, 2009, the company signed a compromise agreement as part of the application for approval as above and the claim (hereafter- the agreement). On April 26, 2010, the Court approved the agreement as a Court Ruling. According to the court decision, the company paid to the applicants, who submitted the application for approval to their representatives and to a society working for preservation of the environment a total of NIS 775 thousands (\$ 203 thousands).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES (continued):

In accordance with further understandings that were agreed upon between the Company and the Ministry of Environmental Protection, the parties signed on 28 June, 2011 addendum to the environmental agreement, where under in the years 2012-2015 the Company will work to gradually transfer production processes with potential smell hazards to its plants outside Israel. These processes constitute app. 2% of the overall global production capacity of Frutarom.

- (c) In addition to the aforementioned, consolidated companies 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 sufficiently provided in its accounts.

The Company believes that the above claim would not have a material effect on its business and operations.

NOTE 12 – 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	
	December 31	
	2012	2011
Authorized	100,000	100,000
Issued and paid	58,266	57,826

Company listed shares are quoted on the TASE at NIS 46.55 (\$12.47) per share as of 31 December, 2012. The GDRs representing the Company's shares are quoted on the official list of the LSE.

- 3) Ordinary Company shares of NIS 1 par value, are held by the company and included in the issued and paid share capital constitute 0.8% (477,711 shares) and 1% (576,283 shares) of the balance of ordinary issued and paid shares of this type as of 31 December 2012 and 2011, respectively.

The purchase cost of those shares was deducted from equity as part of "Cost of Company's shares held by the company and a subsidiary" balance. The shares are held as "Treasury Shares".

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

b. Employee Shares and Option Plans for Senior Employees of Subsidiaries:

- 1) Commencing 2003 and on a semi-annual basis, the Board of Directors resolves to allot options to senior managers and other senior employees based on the recommendations of the remuneration committee. In accordance with the Board of Directors' resolution and taking into consideration the number of shares available to the Company for the purpose of allotment of the options, the Company acquires Company shares in the Stock Exchange and grants the options against those shares.

Through 1 February, 2012, the shares were acquired by Frutarom Trust Ltd. – a fully owned subsidiary; the shares were held in trust until the exercise of the options in respect of which the shares were acquired. Commencing 1 February, 2012, the Company itself acquires and holds the shares designed for grant of options. Options granted in accordance with the 2003 stock option plan ("the 2003 plan") and in accordance with the 2012 stock option plan ("the 2012 plan") are exercisable in three equal batches at the end of every year for a period of 3 years from date of grant. The Board of Directors has the exclusive right to declare the exercise of the options at an earlier date. The exercise price of the option granted in accordance with the said plans, as set determined by the Board of Directors equals a third of the average purchase price paid by the Company in respect of those shares. Options granted under this plan expire at the end of 6 years from date of grant. All tax liabilities arising from grant of options and/or from exercise thereof apply to the employee. The number of exercised shares in respect of each option, as well as the exercise price are adjusted in accordance with the changes in the Company's share capital, such changes originating in split of shares, consolidation of shares, dividend distributed in shares and/or creation of new types of shares, excluding a number of exceptions where the employer-employee relationship between the Company and an employee are terminated; in such a case the employee shall be entitled to exercise all the options exercisable at the date of termination of employer-employee relationship within 90 days from the said date. The remaining options granted to the employee and which were not exercised by the employee shall expire.

Options that are not exercisable at the time of termination of the employer-employee relationship shall expire immediately upon termination of the relationship as above.

The theoretical economic value of the options in respect of grants from 2007 through 2012, is based on the following assumptions: expected dividend yield of 0% for each one of the years 2007-2011, beginning from 2012 dividend yield expected of 0.44%, expected volatility of 25.68%-45.28%; risk-free interest rate of 1.74%-7% (based on the expected term of the option until exercise); and expected term until exercise of: two years in respect of the first batch, three years in respect of the second batch and four years in respect of the third batch.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

The 2012 plan is managed in compliance with the provisions in section 102 to the Israel Income Tax Ordinance.

In accordance with the track chosen by the company and pursuant to the terms thereof, the company is allowed to claim, as an expense for tax purposes, the work income component credited to employees, and is not entitled to claim as an expense for tax purposes the amounts credited to employees as equity benefits.

- 2) Set forth below are data regarding the options under the 2012 Plan, which have not yet been exercised by Company employees, as of December 31, 2012:

<u>Year of grant</u>	<u>Number of options in respect of which the vesting period ended</u>	<u>Number of options in respect of which the vesting period has not yet ended</u>	<u>Exercise price</u> <u>\$</u>
2007	27,757	-	2.88-3.06
2008	33,709	-	2.82 – 3.07
2009	47,822	-	2.65 – 2.77
2010	27,285	49,041	3.15 – 3.22
2011	15,909	42,328	3.24
2012	16,153	202,032	2.96 – 3.2
	<u>168,635</u>	<u>293,401</u>	

As of 31 December, 2012, the remaining amount of compensation, computed as the excess or the fair value of the said options granted to employees over the exercise price at the date of grant not yet recorded as expenses in the income statements is approximately \$530 thousand. The said remaining compensation will be charged to income using the accelerated method over the remaining vesting period.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

As to shares granted to the president of the Company - Note 21.a.2.

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

	2012		2011		2010	
	Average exercise price in U.S. \$ Per share	Options	Average exercise price in U.S. \$ per share	Options	Average exercise price in U.S. \$ per share	Options
Outstanding at 1 January	2.97	417,342	3.10	424,098	2.80	445,332
Granted	3.15	228,914	3.59	73,348	3.18	161,277
Forfeited	3.08	(32,111)	3.07	(17,481)	2.86	(46,440)
Exercised	2.78	(152,109)	2.88	(62,623)	2.77	(136,071)
Balance at 31 December	<u>3.10</u>	<u>462,036</u>	<u>2.97</u>	<u>417,342</u>	<u>3.10</u>	<u>424,098</u>

The following table summarizes information about exercise price and the contractual terms of options outstanding at 31 December, 2012:

Exercise Prices	Share rights outstanding			Share rights exercisable		
	Number outstanding at December 31, 2012	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at December 31, 2012	Weighted average remaining contractual life	Weighted average exercise price
\$		Years	\$		Years	\$
3.06	16,454	0.25	3.06	16,453	0.25	3.06
2.88	14,303	0.75	2.88	11,304	0.75	2.88
3.07	14,908	1.25	3.07	14,908	1.25	3.07
2.82	18,801	1.75	2.82	18,801	1.75	2.82
2.65	17,804	2.25	2.65	17,804	2.25	2.65
2.77	30,019	2.75	2.77	30,018	2.75	2.77
3.22	35,290	3.25	3.22	12,913	3.25	3.22
3.15	41,036	3.75	3.15	14,372	3.75	3.15
3.24	58,237	4.25	3.24	15,909	4.25	3.24
2.96	58,222	4.75	2.96	16,153	4.75	2.96
3.25	70,240	5.25	3.25	-	5.25	3.25
3.21	89,722	5.75	3.21	-	5.75	3.21
	<u>462,036</u>			<u>168,635</u>		

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

- 3) In January 2006, the Company allotted 725,000 options, which are exercisable into 725,000 Company shares to four senior employees as part of a private offering; 350,000 of the said options were granted to the president of the Company and 125,000 were granted to a senior office holder. The options that were granted were exercisable in three equal batches which vested on 1.1.2008, 1.1.2009 and 1.1.2010. The exercise price is NIS 31.068 per share. 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 original expiry date of the options was 2 February, 2012. On 30 January 2012, the Company's Board of Directors resolved to extend the period till expiry by 1 further year till 31 January, 2013 ("extension period"). This resolution was made after the Company's Audit Committee approved the extension of the exercise period. All options were exercised in the course of the extension period.

The theoretical economic value of the allotted shares – computed using the Black & Scholes shares valuation model, amounted at date of grant to U.S. \$1,620 thousand. 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 4.35%-4.45% 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 forty eight months (in accordance with the vesting periods of the batches).

- 4) On 15 July 2010 the Company's Board of Directors approved a plan to grant options to senior managers ("the 2010 plan") based on the recommendations of the remuneration committee; as part of the plan, the Board of Director approved the grant of up to 1,000,000 options (not registered for trade) to the company president and 10 further employees and office holders in the Group; the Board also approved the grant of additional 255,000 options to employees and office holders in the Group ("options for future allocation"). The grant of options to the company president was also approved by the Company's Audit Committee. The options were granted without consideration.

Each option is exercisable into one share for an exercise price of NIS 30.26 which is the closing price of Company's share on the last trading day prior to Board's resolution on such allocation. Each option for future allocation that will be granted to future offerees as part of the plan will be exercisable into one share for an exercise price that will equal an average of closing prices in the ten consecutive trading days prior a Board's resolution on such future allocation, so long as the exercise price of each future allocation option is no less than the par value of Company shares.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

The fair value of the options at date of grant - computed based on the binomial model – is NIS 3.4 million (\$ 0.9 million); this value is based on the following assumptions: adjusted standard deviation of 38% per year, risk-free interest rate of 3.5% and termination rate (prior to end of the vesting period) of 17%; this rate is based on a sample of the changes in manpower of offerees rank for the last several years.

In 2011, the Company granted 40,000 further options to a senior office holder in the Company out of the number of options designed for future allotment; (this grant was also approved by the Company's audit committee). The exercise price in respect of this grant was set to NIS 36.93 (\$10.41); the exercise price is unlinked and is equal to the average closing rates of the Company's share in the 10 trading days that preceded the resolution of the Company's board as to allotment of the options. The theoretical economic value of the options at date of grant - computed using the binomial model – is NIS 0.2 million (\$0.06 million).

On August 20, 2012, the Company's Board of Directors approved the grant of up to 945,000 options (not registered for trade) as part of the 2010 plan to the president and 10 other employees and office holders in the Group; the Board also approved the future grant of up to 200,000 further options to employees and office holders in the Group ("the future options"); the resolution was made based on the recommendations of the remuneration committee. The grant of options to the senior manager was also approved by the Company's Audit Committee. The options were granted without consideration.

Each option is exercisable into one share for an exercise price of NIS 34.85 which is the closing price of Company's share on the last trading day prior to Board's resolution on such allocation. Each future option that will be allotted to future offerees as part of the plan will be exercisable into one share for an exercise price that will equal an average of closing prices in the ten consecutive trading days prior a Board's resolution on such future allocation, so long as the exercise price of each future allocation option is no less than the par value of Company shares. On 1 October, 2012, the Company's Board of Directors approved the allotment of 120,000 options to another senior office holder in the Company as part of the 2010 plan.

The fair value of the options at date of grant - computed based on the binomial model – is NIS 4.7 million (\$ 1.2 million); this value is based on the following assumptions: adjusted standard deviation of 29% per year, risk-free interest rate of 2.7% and termination rate (prior to end of the vesting period) of 11.5%; this rate is based on a sample of the changes in manpower of offerees rank for the last several years.

As to the fair value of the options granted to the president – see note 21.a.2.

The 2010 plan is managed in compliance with the provisions in section 102 to the Israel Income Tax Ordinance.

The Group creates deferred taxes for grants that fall into the scope of IFRS 2 – "Share Based Payment" – in accordance with the proportionate part of the estimated amount deductible for tax purposes by the Group at date of exercise of benefit by the employee and in respect of which work services were provided by the employee.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

through the date of the statement of financial position (i.e., the estimated overall amount deductible for tax purposes divided by the overall vesting period and multiplied by the vesting period that has elapsed through the date of the statement of financial position). The said deferred taxes are recognized in the statement of income.

c. Dividend and Retained Earnings

- 1) 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 2m). The subsidiary's share in the dividend is \$ 27 thousand, \$ 30 thousands and \$26 thousand in 2012, 2011, 2010, 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) is to be deducted from the amount of retained earnings presented among Company's shareholders' equity.
- 2) In its meeting on March 12, 2013, the Company's Board of Directors resolved to distribute a final cash dividend out of retained earnings as of December 31, 2012; the amount of this dividend is \$3,801 thousand (NIS 13,997 thousand). Frutarom Ltd. does not intend to distribute dividend out of tax exempt income arising from "approved enterprise", as explained in Note 13c.
- 3) The dividend paid in 2012 and 2011 amounted to \$ 3,029 thousand (NIS 0.2 per share) and \$ 3,380 thousands (NIS 0.2 per share). As mentioned in 2) above, the dividend in respect of the year ended 31 December 2012 at NIS 0.24 per share and totaling \$3,801 thousand was discussed in the Company's Board of Directors.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 - TAXES ON INCOME:

a. Corporate taxation in Israel

- 1) Commencing 2008, the results for tax purposes of the Company and its Israeli subsidiaries are measured in nominal values. The Israeli companies are companies of foreign investors and have elected to keep their books and records in dollars for tax purposes, as permitted under the Income Tax Regulations (Principles for the Bookkeeping of Foreign Invested Companies and of Certain Partnerships and the Determination of Their Taxable Income), 1986.

2) Tax rates

The income of the Company and its Israeli subsidiaries (other than income from "approved" or "beneficiary enterprises") is taxed at the regular rate; under the provisions of the Law for Amendment of the Income Tax Ordinance, 2005, of August 2005 and the provisions of the Economic Rationalization Law (Legislation Amendments for the Implementation of the Economic Plan for the years 2009 and 2010), of July 2009, the corporate tax rates is to be gradually reduced as from 2010 and thereafter, as follows: 2010 – 25%, 2011 – 24%, 2012 – 23%, 2013 – 22%, 2014 – 21%, 2015 – 20%, 2016 and thereafter – 18%.

On December 6, 2011, the "Tax Burden Distribution Law" Legislation Amendments (2011) was published in the official gazette. Under this law, the previously approved gradual decrease in corporate tax is discontinued. Corporate tax rate will increase to 25% as from 2012.

Capital gains of the Company are subject to tax at the regular corporate tax rate applicable during the tax year. However capital gains derived prior to January 1, 2003 are taxed at a rate of 26% in 2009, 25% in 2010 and 24% in 2011. Commencing 2012, the tax rate applicable to all capital gains of the Company shall be 25%.

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:

Companies incorporated in the USA – tax rate of 41% - 42%

Companies incorporated in Germany – tax rate of 30%

Company incorporated in Belgium – tax rate of 34%

Company incorporated in Italy – tax rate of 31.4%

Company incorporated in Norway – tax rate of 28%.

Companies incorporated in the UK – tax rate of 24% (January – March 2012 – tax rate of 26%, April 2012 through March 2013 tax rate of 24%; commencing April 2013 – tax rate of 23%).

Company incorporated in the Switzerland – tax rate of 22%.

Company incorporated in Slovenia – tax rate of 18%

Companies incorporated in China – tax rate of 25%

Companies incorporated in Brazil – tax rate of 34%

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 that was available to Frutarom Ltd till 2010 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 or benefited 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).
- (2) Tax exemption on income from certain approved enterprises which had previously opted for by Frutarom Ltd. the "alternative benefits" track (involving waiver of investment grants) and tax exemption on income from a benefited enterprise; the length of the exemption period is two, four or six years, after which the income from these enterprises is taxable at a decreased rate (see 1a above) for an additional eight, six or four years, respectively.

That part of income eligible for tax benefits as above is based on the ratio between the turnover allocated to the "approved enterprise" or "benefited enterprise" and the overall turnover of the enterprise.

In accordance with the Encouragement of Capital Investments Regulations (Erosion of Base Turnover), 2007, Frutarom Ltd. is eligible for base turnover erosion subject to complying with the provisions of the said regulations.

In the event of distribution of cash dividends out of income, which was tax exempt as above (including liquidation dividend for benefited enterprises), Frutarom Ltd. would have to pay the decreased tax rate (see 1a above) in respect of the amount distributed, (Note 2p).

(b) 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.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

(c) 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. As mentioned above, as of 31 December 2012, the Group meets the requirements.

2) Amendment to the Israel Capital Investment Encouragement Law, 1959

The Israel Law of Economic Policy for the Years 2011 and 2012 (Legislation Amendments), which was passed by the Knesset (the Israeli parliament) on December 29, 2010, includes an amendment to the Israel Capital Investment Encouragement Law, 1959 (hereinafter - the amendment). The amendment became effective on January 1, 2011.

The amendment sets out benefit tracks to replace those provided by the Law for Encouragement of Capital Investments, 1959 (hereafter – the law) before it was amended. Key changes in programs include a grants program for entities in development area A, and two new tax benefit programs ('preferred enterprise' and 'special preferred enterprise'). In essence, these provide a uniform tax rate on the entire preferred income of an entity, as the term preferred income is defined in the amendment.

Corporate tax rate under the law are:

Years	Development area A	All other parts of Israel
'Preferred enterprise'		
2011-2012	10%	15%
2013-2014	7%	12.5%
2015 and thereafter	6%	12%
'Special preferred enterprise'		
2011 and thereafter	5%	8%

Benefits will be provided to a preferred enterprise indefinitely, as opposed to a special preferred enterprise, which will receive benefit for a period of 10 years. Benefits are to be given to qualifying companies under the amendment, based on criteria similar to those prescribed by the law prior to the amendment. Transition provisions in the amendment state that a company will be able to continue benefit from tax breaks under the previous version of the law until it is amended and until the end of the benefits period, as defined by the law. A company will be permitted to set a 'year of election' that will be not later than the 2012 tax year, as long as the minimum qualifying investment started through the end of 2010. In each year during the period of benefits, the company will be entitled to decide to irreversibly enter the scope of the amendment and to benefit from preferable tax rates.

The Company entered the scope of the amendment beginning in the 2011 tax year.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

3) The Law for the Encouragement of Industry (Taxation), 1969:

- a. Frutarom Ltd. is an “industrial company” as defined by this law. As such, Frutarom Ltd. is entitled to claim amortization 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.
- b. The Company and Frutarom Ltd. file a consolidated tax return in accordance with the Law for the Encouragement of Industry. Accordingly, each company is entitled to set-off its tax losses (created commencing the year in which consolidated reporting for tax purposes began) against the taxable income of the other company, subject to certain restrictions.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

d. Deferred Income Taxes

1) Composition of deferred taxes as of dates of statements of financial position and changes therein in those years are as follows:

	Depreciable fixed assets	Provisions for employee rights	Vacation and recreation pay	Inventories	Other	Depreciable intangibles	In respect of Carry forward tax losses	Total
		Severance Pay						
	U.S. dollars in thousands							
Balance at 1 January, 2011	12,926	(1,407)	(165)	(1,535)	(335)	11,021	-	20,505
Changes in 2011:								
Additional taxes as a result of acquisition of subsidiaries	(327)	-		255	37	2,107	-	2,072
Differences from translation of foreign currency financial statements of subsidiaries	(75)	12		(18)	7	(296)	32	(338)
Amounts carried to c income	437	340	(10)	369	165	(485)	(459)	357
Balance at 31 December 2011	12,961	(1,055)	(175)	(929)	(126)	12,347	(427)	22,596
Changes in 2012:								
Additional taxes as a result of acquisition of Subsidiaries	3,095	-	-	(27)	(17)	2,266	(3,329)	1,988
Differences from translation of foreign currency financial statements of subsidiaries	313	(27)		33	22	393	(112)	622
Amounts carried to c income	226	(77)	(15)	(290)	(484)	1,461	(1,811)	(990)
Balance at 31 December 2012	16,595	(1,159)	(190)	(1,213)	(605)	16,467	(5,679)	24,216

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

- 2) Deferred taxes are presented in the statements of financial position as follows:

	December 31	
	2012	2011
	U.S. dollars in thousands	
Among non-current assets	3,075	2,073
Among non-current liabilities	(27,292)	(24,669)
	<u>(24,217)</u>	<u>(22,596)</u>

- 3) The deferred taxes in respect of Group activities in Israel are computed at the tax rate of 13% (2011 – 13%). This rate is an average taking into account the tax rates applicable to income from Frutarom Ltd.'s preferred enterprises (in accordance with the amendment to the law, see also note 13c2).

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

e. Taxes on Income Included in The Income Statements for the presented periods:

- 1) As follows:

	2012	2011	2010
	U.S. dollars in thousands		
Current taxes:			
For the reported year's income	15,335	11,592	15,178
Adjustments in respect of previous years	(717)	(1,114)	577
	<u>14,618</u>	<u>10,478</u>	<u>15,755</u>
Deferred taxes:			
Creation and reversal of deferred taxes	(990)	357	(80)
T o t a l	<u>13,628</u>	<u>10,835</u>	<u>15,675</u>

Current taxes are computed in accordance with the statutory tax rates of Group entities around the world (see above) and in accordance with relevant tax benefits for each country.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

- 2) 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 13c above) and the actual tax expense:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	<u>U.S. dollars in thousands</u>		
Income before taxes on income, as reported in the income statements	65,608	52,866	59,786
Theoretical tax expense in respect of this income – at 25% (2011 – 24%; 2010 – 25%)	16,402	12,688	14,947
Less – tax benefit arising from approved enterprise /benefited enterprise status	(1,158)	(1,788)	(806)
Increase in taxes resulting from different tax rates applicable to foreign subsidiaries	52	1,167	2,922
Decrease in taxes arising from computation of deferred taxes at a rate which is different from the theoretical rate	(159)	331	(764)
Increase (decrease) in deferred taxes as a result of future changes in the tax rates	-	(170)	(533)
Increase (decrease) in taxes arising from permanent differences – disallowable expenses (income)	(412)	(76)	(5)
Decrease in taxes resulting from utilization, in the reported year, of carry forward tax losses and other expenses 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)	(372)	(151)	(502)
Difference between the basis of measurement of income reported for tax purposes and the basis of measurement of income for financial reporting purposes – net	-	-	15
Income taxes in different tax rates	-	-	-
Other	(8)	(52)	(176)
Taxes on income for the reported year	<u>14,345</u>	<u>11,949</u>	<u>15,098</u>

f. Tax Assessments

The Company and its Israeli subsidiaries have received final tax assessments through the year 2008.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

g. Effect of adoption of IFRS in Israel on tax liability

As mentioned in note 2a, the Group prepares its financial statements in accordance with IFRS.

As also indicated in the said note, IFRS vary from Accounting Principles Generally Accepted in Israel and accordingly, preparation of financial statements in accordance with IFRS may reflect a financial position, results of operations and cash flows that are materially different from the ones presented in financial statements presented in accordance with accounting principles generally accepted in Israel.

In accordance with the law for the amendment of the Income Tax Ordinance (No. 174 – Temporary Order as to Tax Years 2007, 2008 and 2009), 2010 that was passed in the Knesset on January 25, 2010 and published in the official gazette on February, 4, 2010 (hereafter – the amendment to the ordinance), Accounting Standard No. 29 issued by the Israel Accounting Standard Board would not apply upon determining the taxable income for tax purposes in respect of tax years 2007, 2008 and 2009; this would be the case even if the said accounting standard was applied for the said tax years in the financial statements.

The meaning of the amendment to the ordinance is that IFRS would actually not be applied upon computation of the income reported for tax purposes for the said tax years.

On 31 October, 2011 the Government of Israel published a law memorandum in connection with the amendment to the Income Tax Ordinance (hereafter – the law memorandum) resulting from application of IFRS in the financial statements. Generally, the law memorandum adopts IFRS. Nevertheless, the law memorandum suggests making several amendments to the Income Tax Ordinance, which will serve to clarify and determine the manner of computation of taxable income for tax purposes in cases where the manner of computation is not clear and IFRS do not comply with the principles of the tax method applied in Israel. At the same time, the law memorandum generally adopts IFRS. The legislation procedures relating to the law memorandum have not yet been completed and it is doubtful whether they shall be completed in the near future.

Since the legislation procedures relating to the law memorandum have not yet been completed the Company estimates that the term of the temporary order which applies to the years 2007 to 2011 shall be extended so that it will also apply to 2012. In view of the fact that the temporary order applies to tax years 2007 to 2011 as above and in view of the potential extension of the term of the temporary order to 2012, the Group's management expects that at this stage the new legislation shall not apply to tax years preceding 2013.

Taking into consideration the temporary order which applies to tax years 2007 to 2011 and the Company's estimate regarding the potential extension of the term of the temporary order to 2012 as above, the Company computed its taxable income for tax years 2007 to 2012 based on Israeli accounting standards applicable prior to adoption of IFRS in Israel, subject to certain adjustments

The amendment to the ordinance did not have a material effect on the tax expenses reported in these financial statements.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- a. To secure borrowings and long-term loans received by a US subsidiary, this subsidiary recorded a charge on current inventory and trade receivables.
- b. To secure long-term loans and other services received by subsidiaries in Israel and the UK, the subsidiary in Israel and subsidiary in the UK recorded a negative pledge on their assets.
- c. To secure the long-term loan extended by Bank Leumi Ltd. Bank Leumi Ltd. in the USA, the First International Bank of Israel Ltd. and by two Swiss banks the Group has undertaken upon itself to meet the following financial criteria:
 - 1) The amount representing the Group's equity would not be lower than \$300 million at any given time. As of 31.12.2012 the Group's equity amounts to \$ 453,560 thousands.
 - 2) The amount representing the Group's equity would not be lower than 35% of total assets. As of 31 December, 2012, the Company's equity equals 58.7% of total Company balance sheet.
 - 3) The ratio between the total financial liabilities of the Group and its operating profit before tax expenses with the addition of depreciation and amortization would not exceed 4.25. As of 31 December, 2012 the said ratio is 1.4.
- d. To secure borrowings and banking services received from Bank Leumi Ltd. and the First International Bank of Israel Ltd., the Company has undertaken to meet the following restrictions regarding dividend distribution. The Company shall be allowed to distribute as dividend:
 - 1) Up to 50% of the retained earnings accumulated through 31 December 2011; based on the retained earnings balance recorded in the Company's balance sheet as of 31 December 2011.
 - 2) Up to 50% of the Company's net income for each calendar year based on the net income data recorded in the Company's statement of income for the calendar year during which the said income was accumulated.
- e. To secure a long-term loan received by a Swiss subsidiary, the Swiss subsidiary and its subsidiaries recorded a negative pledge on their assets.
- f. To secure a long-term loan extended by two Swiss banks, the Swiss subsidiary has undertaken to meet the following financial covenants to be computed on the basis of the consolidated financial statements of the subsidiary and all the companies it owns (hereafter – the Swiss group):
 - 1) The ratio between debt net of cash and EBITDA shall not exceed 3. As of 31 December 2012, the ratio was 1.07.
 - 2) The amount of equity shall not be lower than 35% of total balance sheet of the Swiss group. As of 31 December 2012 the ratio was 48.2%.

As mentioned above, as of 31 December 2012, the Group meets its obligations.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 15 – ACCOUNTS RECEIVABLE:

	December 31	
	2012	2011
	U.S. dollars in thousands	
a. Trade – composed as follows:		
Open accounts	104,396	84,217
Interested parties	342	139
	<u>104,738</u>	<u>84,356</u>
Cheques collectible	2,016	1,698
	<u>106,754</u>	<u>86,054</u>
The item includes – provision for doubtful accounts	<u>3,640</u>	<u>2,808</u>

As of 31 December, 2012 certain trade receivable balances– amounting to \$ 22,636 thousands (2011 - \$ 17,514 thousands) are in arrears of up to 120 days after date in which payment was due. A provision for doubtful account in the total amount of \$961 thousand (2011 - \$ 1,167 thousands) was made in respect of it of those balances.

Those balances include the accounts of a large number of customers, in respect of which the Company has not encountered lately any collection problems. The carrying amount of accounts receivable is a reasonable approximation of their fair value since the effect of discounting is immaterial.

The aging analysis of these trade-receivable balances is as follows:

	December 31	
	2012	2011
	U.S. dollars in thousands	
Through 90 days	21,694	16,884
90 to 120 days	942	630
	<u>22,636</u>	<u>17,514</u>
Provision for doubtful accounts	(961)	(1,167)
	<u>21,675</u>	<u>16,347</u>

As of 31 December, 2012, the Company made a provision for doubtful accounts in respect of balances in the total amount of \$2,957 thousand (2011 – \$2,582 thousand) in arrears of more than 120 days. The amount of the provision as of 31 December, 2012 was \$2,379 thousand (2011 – \$1,641 thousand).

The aging of the said balances is presented below:

	December 31	
	2012	2011
	U.S. dollars in thousands	
120 days to 1 year	1,483	1,639
Over 1 year	1,474	943
	<u>2,957</u>	<u>2,582</u>
Provision for impairment of receivables	(2,379)	(1,641)
	<u>578</u>	<u>941</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 15 – ACCOUNTS RECEIVABLE (continued):

Amounts charged to provision for doubtful accounts or released therefrom were included among "selling, marketing, research and development expenses" in the statement of income (see note 20b).

	December 31	
	2012	2011
	U.S. dollars in thousands	
b. Other:		
Employees and institutions	398	272
Government institutions	9,173	5,872
Sundry	1,378	846
	<u>10,949</u>	<u>6,990</u>

NOTE 16 – INVENTORIES

	December 31	
	2012	2011
	U.S. dollars in thousands	
Raw materials and supplies	61,180	52,537
Products in process	10,697	6,976
Finished products	48,299	50,144
	<u>120,176</u>	<u>109,657</u>
Inventories for commercial operations – purchased products	2,257	1,557
	<u>122,433</u>	<u>111,214</u>

NOTE 17 – OTHER

	December 31	
	2012	2011
	U.S. dollars in thousands	
Prepaid expenses in respect of operating lease	60	67
Asset in respect of employee benefits	102	-
Sundry	217	-
	<u>379</u>	<u>67</u>

NOTE 18 – CASH AND CASH EQUIVALENTS:

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

	Weighted Interest rates as of 31 December 2012	December 31	
		2012	2011
		U.S. dollars in thousands	
In Dollars	0.2%	18,157	12,804
In Pounds sterling	-	2,953	4,896
In Euro	0.1%	19,046	10,649
In Swiss Francs	0.1%	3,533	772
Yuan	0.1%	2,878	4,949
NIS	-	1,008	783
Brazilian real	7.3%	3,257	-
Other		3,101	1,619
		<u>53,933</u>	<u>36,472</u>

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 19 – ACCOUNTS PAYABLE:

	December 31	
	2012	2011
	U.S. dollars in thousands	
a. Trade:		
Open accounts	48,237	40,239
b. Other:		
Payroll and related expenses	11,439	10,759
Government institutions	14,682	7,418
Provision for commissions and discounts	2,527	2,282
Accrued expenses	8,674	7,341
Provisions	320	236
Conditional consideration in respect of acquisition of subsidiaries	657	9,793
Sundry	970	615
	<u>39,269</u>	<u>38,444</u>

The carrying amount of accounts payables is a reasonable approximation of their fair value since the effect of discounting is immaterial.

NOTE 20 – INCOME STATEMENT ANALYSIS:

	Year ended 31 December		
	2012	2011	2010
	U.S. dollars in thousands		
a. Cost of Sales:			
Industrial operations:			
Materials consumed	279,694	256,031	200,141
Payroll and related expenses	48,763	44,408	38,400
Depreciation and amortization	13,134	11,209	9,926
Other production expenses	32,734	29,206	25,758
	<u>374,325</u>	<u>340,854</u>	<u>274,225</u>
Decrease (increase) in work in process and finished products inventories	(1,876)	(16,034)	(2,372)
	<u>372,449</u>	<u>324,820</u>	<u>271,853</u>
Commercial operations – cost of products sold	19,293	5,046	4,389
	<u>391,742</u>	<u>329,866</u>	<u>276,242</u>
b. Selling, Marketing, Research and Development Expenses – net:			
Payroll and related expenses	54,369	48,136	41,386
Transportation and shipping	16,196	14,335	12,164
Provisions for payment of commissions	5,841	3,742	3,109
Provision for doubtful accounts	(441)	(347)	214
Depreciation and amortization	8,510	5,984	5,253
Travel and entertainment	4,015	3,416	2,733
Office rent and maintenance	4,818	3,902	3,841
Other	11,624	9,473	8,361
	<u>104,932</u>	<u>88,641</u>	<u>77,061</u>
The item includes expenses for product development and research activities, net*	28,031	24,333	21,563
* net of participation from government departments and others	384	655	992

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 20 – INCOME STATEMENT ANALYSIS (continued):

	Year ended 31 December		
	2012	2011	2010
	U.S. dollars in thousands		
c. General and Administrative Expenses:			
Payroll and related expenses	28,852	23,864	20,720
Depreciation and amortization	4,368	3,419	2,902
Professional fees	3,094	2,110	2,067
Communication, office supplies and Maintenance	5,266	4,416	5,031
Travel and entertainment	1,595	1,686	1,396
Other	6,022	3,736	2,983
	<u>49,197</u>	<u>39,231</u>	<u>35,099</u>
d. Other Expenses (income) – net:			
Capital loss on sale of fixed assets	92	17	(508)
Rental	(11)	(36)	(69)
Expenses relating to acquisition of subsidiaries	954	1,876	85
Expenses for institutional audit	-	150	223
Other	(24)	34	(49)
Income from bargain purchase	(1,729)	-	-
	<u>(718)</u>	<u>2,041</u>	<u>(318)</u>
e. Financial Expenses – net:			
In respect of long-term loans and credit	5,154	1,489	1,749
In respect of exchange differences of trade receivables and trade payable balances – net	48	3,254	1,107
In respect of cash and cash equivalents, short-term deposits and loans, short- term credit and other – net	2,038	1,055	340
	<u>7,240</u>	<u>5,798</u>	<u>3,196</u>

NOTE 21 - RELATED PARTIES - TRANSACTIONS AND BALANCES:

a. Transactions with Related Parties:

"Interested parties" - As this term is defined in Israel Securities Regulations (Annual Financial Statements), 2010.

"A related party" - As this term is being defined in IAS 24 - "Related Party Disclosure" (hereafter – IAS 24R).

Key management personnel, who are included together with other officer holders, in the definition of "related party" as per IAS 24R) include the members of the board of directors and the president and CEO of the Company

The main shareholder of the company is ICC Industries Inc. which is holding 36.66% of company shares. The remaining shares are widely held. The controlling shareholder in ICC Industries Inc. is Dr. John Farber – the Chairman of the Board of Directors, who also holds 0.08% of Company's shares.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 21 – RELATED PARTIES – TRANSACTIONS AND BALANCES (continued):

1) Transactions with the controlling shareholder and its affiliates:

During the ordinary course of business, the Company and its affiliates conduct negligible transactions with the companies affiliated to the controlling shareholder. As part of these transactions, the Company's subsidiary sells to Fallek Chemical Japan, an affiliate of the controlling shareholder, products at market prices for marketing to a specific customer in Japan. In addition, as part of these transactions, the Company purchases from Azur S.A., an affiliate of the controlling shareholder, raw materials at cost prices and production services at market price. These transactions were approved by the Company's Board of Directors and they are considered to be negligible as this term is defined by regulation 41(a)(6)(a) of the Securities Regulations (Annual Financial Reports), 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	<u>U.S. dollars in thousands</u>		
Income (expenses):			
Sales – affiliates (companies controlled by the controlling shareholder):			
Fallek Chemical Japan	574	405	593
Other	4	9	9
	<u>578</u>	<u>414</u>	<u>602</u>
Purchases:			
Affiliates (companies controlled by the controlling shareholder):			
Azur S.A	(1,743)	(1,819)	(1,689)
Dividend	<u>(1,132)</u>	<u>(1,257)</u>	<u>(1,019)</u>
Other expenses:			
Affiliates -			
Azur S.A.	<u>(42)</u>	<u>(35)</u>	<u>-</u>
Benefits to related parties:			
Wages and salaries	<u>(2,603)</u>	<u>(2,119)</u>	<u>(2,040)</u>
Director fees (in the Company)	<u>(186)</u>	<u>(192)</u>	<u>(150)</u>

2) Shares granted to the President of the Company

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

On January 30, 2012, the Company's board of directors resolved to extend by one year the exercise period of the options until 31 of January 2013. The total benefit granted to the President due to the extension is \$202 thousand.

On July 15, 2010, the Company's board of directors approved the grant of 275,000 options to the President of the Company; the value of the benefit is computed in accordance with the binomic model and was estimated at \$ 322 thousands at date of grant.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 21 – RELATED PARTIES – TRANSACTIONS AND BALANCES (continued):

On August 20, 2012, the Company's board of directors approved the grant of 275,000 options to the President of the Company; the value of the benefit is computed in accordance with the binomic model and was estimated at \$ 434 thousands at date of grant.

The total benefit component granted to the President under the 2012 and 2010 plans (see note 12) in the years 2012, 2011 and 2010 as computed at date of grant is \$806 thousand, \$156 thousand and \$516 thousand, respectively.

Benefit costs that have been charged to the income statements, in respect of the said shares granted in the years 2012, 2011 and 2010 are \$513 thousand \$ 216 thousands and \$223 thousand, respectively.

3) Terms of the employment update for the President of the Company

On December 6, 2012, the Company's Board of Directors approved formalization of the President's annual bonus as part of his existing terms of employment.

The annual bonus to which the President shall be entitled will be comprised of two components – a cash component and an equity based component, to be determined according to formulas prescribed in the agreement, as follows:

Cash component:

Annual EBITDA excluding one-time items US\$M	Bonus %	Comments
0-50	0	
50-70	1.1	On the entire amount
70-100	1.2	On the incremental part only
Above 100	1.3	On the incremental part only

According to the formula prescribed as appears in the table above, EBITDA higher than the threshold amount prescribed (“Threshold Amount”) entitles the President to an annual bonus according to levels set, and above the first level, the percentage of the increased bonus relates to the delta between the levels only (i.e., the increment).

The bonus will be paid to the President at the time of payment of the first monthly wage following the date of the Board of Directors' approval of the Company's annual financial statements.

Equity based component:

Annual EBITDA excluding one-time items US\$M	Bonus %	Comments
0-50		
50-70	0.25	On the entire amount
70-100	0.275	On the incremental part only
Above 100	0.290	On the incremental part only

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 21 – RELATED PARTIES – TRANSACTIONS AND BALANCES (continued):

According to the formula prescribed as appears in the table above, EBITDA higher than the Threshold Amount entitles the President to options for the purchase of Company shares under 2012 option plan to whose overall market value at the time of their purchase is equal to 1.5 times the amount of the said bonus component, so that the bonus amount constitutes 2/3 the value of the options granted to the President, and the exercise price of the options to be paid by the President will constitute 1/3 the value of the Company shares at the time of their purchase.

The formula for calculating this component was determined according to the levels in the table above, and above the first level, the percentage of the increased bonus relates to the delta between the levels only (i.e., the increment).

The annual bonus, including both components thereof, is limited to a cap of US\$ 2.5 million.

- 4) The articles of incorporation of the company allow insurance coverage to officials in the company as outlined by Israeli legislation. The company applied a policy of indemnifying officers and other officials in subsidiaries. The company decided to buy insurance to officers in relation to their job, subject to the law and other restrictions.

b. Balances with Related Parties:

	31 December		
	2012	2011	2010
	U.S. dollars in thousands		
1) Current receivables – presented among “other receivables-other” and “trade receivables” Affiliated companies:			
Fallek	342	137	275
ICC	-	2	-
	<u>342</u>	<u>139</u>	<u>275</u>
Highest balance during the year	<u>342</u>	<u>221</u>	<u>293</u>
2) Current payables shareholder and related parties:			
Azur S.A.	18	57	29
	<u>18</u>	<u>57</u>	<u>29</u>

NOTE 22 – SUBSEQUENT EVENTS:

Distribution of dividend

On March 12, 2013 the Company’s Board of Directors declared the distribution of a dividend of NIS 0.24 per share. Total amount of the dividend is \$3,801 thousand (based on exchange rate as of date of confirmation of these financial statements).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 23 – LIST OF CONSOLIDATED SUBSIDIARIES AND INVESTMENT IN SUBSIDIARIES

a) LIST OF CONSOLIDATED SUBSIDIARIES

Name of company	Country	Percentage of shareholding and control	
		31 December	
		2012	2011
		%	%
Subsidiaries:			
Frutarom Ltd.(1)	Israel	100	100
Frutarom Trust Ltd.(2)	Israel	-	100
(1)Frutarom Ltd. holds the following companies:			
Frutarom Trade and Marketing (1990) Ltd.	Israel	100	100
Galilee Essences Ltd.(3)	Israel	-	100
Frutarom (UK) Holdings. (4)	U.K.	100	100
International Frutarom Corporation (5)	U.S.A	100	100
Frutarom Russia Ltd.	Russia	100	100
Frutarom Ukraine Ltd.	Ukraine	100	100
Frutarom Kazakhstan LLP.	Kazakhstan	100	100
Frutarom Flavors (Kunshan) Company	China	100	100
Frutarom Gida Urunleri San. ve Tic.Ltd. Sti.	Turkey	100	100
Frutarom Mexico S.A	Mexico	100	100
Frutarom do Brazil Ltd.(6)	Brazil	100	100
Frutarom F&F (Shanghai) Trading .co.Ltd.	China	100	100
Frutarom South Africa (Proprietary) Ltd.	South Africa	75	75
Turkish Holdings Ltd. (3)	Turkey	100	100
Notra Liz Ltd.	Israel	55	55
Frutarom (Asia Pacific) Ltd.(7)	Hong Kong	100	100
Frutarom Singapore Pte Ltd.	Singapore	100	-
(2)The company has been closed in 2012.			
(3)Inactive company			
(4) Frutarom (UK) Holdings Ltd. holds full ownership in the following companies:			
Frutarom Switzerland Ltd.(8)		100	100
Frutarom (UK) Ltd.(9)		100	100
Frutarom Italy S.R.L. (10)		100	100
Frutarom Norway A.S.		100	100
(5) International Frutarom Corporation holds the following companies:			
Frutarom U.S.A. Inc.(11)		100	100
Frutarom Flavor & Fragrance Costa Rica SRL.		100	-
(6) Frutarom do Brazil Ltd holds full ownership in:			
Vila Osorio Participacoes S/A(12)		100	-
(7) Frutarom (Asia Pacific) Ltd. holds in the following companies:			
Frutarom Flavors & Ingredients (Shanghai) (**)		99	99
(8) Frutarom Switzerland Ltd. has full ownership in the following companies:			
Frutarom Germany GmbH(13)		100	100
Frutarom Nordic A/S		100	100
Frutarom France S.A.R.L		100	100
Frutarom (Marketing) S.R.L(3)		100	100
Frutarom Netherlands B.V.(14)		100	100
Frutarom Etol Tovarna arom in etericnih d.o.o(15).		100	-

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 23 – LIST OF CONSOLIDATED SUBSIDIARIES (continued):

Name of company	Country	Percentage of shareholding and control	
		31 December	
		2012	2011
		%	%
(9) Frutarom (UK) Ltd. has full ownership in the following companies:			
Aromco Ltd.		100	100
Savoury Flavors (Holdings) Ltd (17)		100	-
(10) Frutarom Italy S.R.L. has holdings in the following companies:			
Frutarom Czech Republic S.r.o. (***)		90	90
(11) Frutarom U.S.A. Inc. has full ownership in the following companies:			
Frutarom USA Holdings Inc.		100	100
Flavors system International Inc.(18)		100	100
(12) Vila Osorio Participacoes S/A has holdings in the following companies:			
Mylner Industria E Comercio Ltda		100	-
(13)Frutarom Germany GmbH has holdings in the following companies:			
Frutarom Savory Solutions GmbH (19)		100	100
(14)Frutarom Netherlands B.V. holds full ownership in the following companies:			
Frutarom Belgium N.V.		100	100
(15) Frutarom Etol Tovarna arom in etericnih olj d.o.o has holdings in the following companies:			
Etol Polska SP z.o.o.		100	-
Etol JVE d.o.o.		100	-
Etol Skopje (20)		100	-
Etol Kazahstan t.o.o.		100	-
Etol SK s.r.o. CZ		100	-
Etol Russia Ltd.		100	-
(16) Aromco Ltd. has holdings in the following companies::			
Aromco South Africa (PTY) Ltd		100	100
MIS Aromco Flavors India (p) Ltd		100	100
(17) Savoury Flavors (Holdongs) Ltd has holdings in the following companies::			
Savoury Flavors Ltd.		100	-
Imarco Food Ingredients Ltd		100	-

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 23 – LIST OF CONSOLIDATED SUBSIDIARIES (continued):

(18) Flavors system International Inc. holdings in the following companies::		
FSI Beverage System, LLC	100	100
FSI Fragrance, LLC	100	100
(19) Frutarom Savory Solutions GmbH holdings in the following companies::		
GewürzMüller AG(3)	100	100
NESSEpol Sp. z.o.o	100	100
(20) Etol Škopje holdings in the following companies::		
Ingrediants dooel Škopje	100	-

(*) the remaining percentage is held by Frutarom Industries .Ltd.

(**) the remaining percentage is held by Frutarom F&F (Shanghai) Trading .co.Ltd.

(***) the remaining percentages are held by Frutarom (UK) Holdings.

b) INVESTMENT IN SUBSIDIARY HELD DIRECTLY BY THE COMPANY

<u>Name of the subsidiary</u>	<u>State of Incorporation</u>	<u>Percentage of shareholding</u>	<u>The value of the investment</u>	<u>Capital notes</u>
			<u>31 December 2012</u>	
			<u>U.S. dollars in thousands</u>	
Frutarom Ltd.	Israel	100%	344,574	105,073