

FRUTAROM INDUSTRIES LTD.

2011 FINANCIAL STATEMENTS

FRUTAROM INDUSTRIES LTD.
2011 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, 2011. 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, 2011.

We also audited, the Company's financial statements as of December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011, in accordance with generally accepted auditing standards, and our report, of March 14, 2012 included an unqualified opinion on these financial statements.

Haifa, Israel
14, March, 2012

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, 2011 and 2010 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, 2011. 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 information of certain consolidated companies, whose assets included in consolidation constitute approximately 13% and 11% of total consolidated assets as of December 31, 2011 and 2010, and whose revenues included in consolidation constitute approximately 14%, 13%, and 12% of total consolidated revenues for each of the years in the period ended December 31, 2011. 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, 2011 and 2010 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, 2011, 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, 2011, and our report of March 14, 2012 included an unqualified opinion on the effectiveness of those components.

Haifa, Israel
14, March, 2012

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| | Note | As of 31 December | |
|--|------|---------------------------|----------------|
| | | 2011 | 2010 |
| | | U.S. dollars in thousands | |
| A s s e t s | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | 18 | 36,472 | 44,389 |
| Accounts receivable: | 15 | | |
| Trade | | 86,054 | 69,820 |
| Other | | 6,990 | 10,836 |
| Prepaid expenses and advances to suppliers | | 5,916 | 2,736 |
| Inventories | 16 | 111,214 | 86,485 |
| | | 246,646 | 214,266 |
| NON-CURRENT ASSETS : | | | |
| Property, plant and equipment – net | 7 | 145,455 | 126,122 |
| Intangible assets – net | 2f;8 | 255,710 | 177,136 |
| Deferred income tax assets | 13d | 2,073 | 1,362 |
| Prepaid expenses in respect of operating lease | 17 | 67 | 163 |
| | | 403,305 | 304,783 |
| T o t a l a s s e t s | | 649,951 | 519,049 |

| | |
|----------------------------------|---|
| |) |
| 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 14, 2012.

| | Note | As of 31 December | |
|--|------|---------------------------|----------------|
| | | 2011 | 2010 |
| | | 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 | 52,699 | 32,302 |
| Accounts payable: | 19 | | |
| Trade | | 40,239 | 30,380 |
| Other | | 38,444 | 31,438 |
| | | <u>131,382</u> | <u>94,120</u> |
| NON-CURRENT LIABILITIES: | | | |
| Long-term loans net of current maturities | 9 | 88,947 | 32,028 |
| Retirement benefit obligations, net | 10 | 11,359 | 11,242 |
| Deferred income tax liabilities | 13d | 24,669 | 21,867 |
| | | <u>124,975</u> | <u>65,137</u> |
| COMMITMENTS AND CONTINGENT LIABILITIES | 11 | | |
| Total liabilities | | <u>256,357</u> | <u>159,257</u> |
| EQUITY: | | | |
| Ordinary shares | 12 | 16,597 | 16,597 |
| Capital surplus | | 97,356 | 96,630 |
| Translation differences | 2c | 12,356 | 17,611 |
| Retained earnings | | 270,266 | 231,615 |
| Less - cost of Company shares held by subsidiary | | (2,981) | (2,661) |
| Total equity | | <u>393,594</u> | <u>359,792</u> |
| Total equity and liabilities | | <u>649,951</u> | <u>519,049</u> |

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED INCOME STATEMENTS

| | | Year ended 31 December | | |
|--|-------------|---|----------------------|----------------------|
| | | 2011 | 2010 | 2009 |
| | | U.S. dollars in thousands, (except for per share data) | | |
| | Note | | | |
| SALES | | 518,443 | 451,066 | 425,179 |
| COST OF SALES | 20a | 329,866 | 276,242 | 269,677 |
| GROSS PROFIT | | <u>188,577</u> | <u>174,824</u> | <u>155,502</u> |
| Selling, marketing, research and development expenses - net | 20b | 88,641 | 77,061 | 75,408 |
| General and administrative expenses | 20c | 39,231 | 35,099 | 33,004 |
| Other expenses (income) - net | 20d | 2,041 | (318) | (195) |
| INCOME FROM OPERATIONS | | <u>58,664</u> | <u>62,982</u> | <u>47,285</u> |
| FINANCIAL EXPENSES (INCOME) – net | 20e | 5,798 | 3,196 | 4,344 |
| INCOME BEFORE TAXES ON INCOME | | <u>52,866</u> | <u>59,786</u> | <u>42,941</u> |
| INCOME TAX | 13e | 10,835 | 15,675 | 9,721 |
| NET INCOME FOR THE YEAR | | <u><u>42,031</u></u> | <u><u>44,111</u></u> | <u><u>33,220</u></u> |
| | | U.S dollars | | |
| EARNINGS PER SHARE: | 2v | | | |
| Basic | | <u>0.73</u> | <u>0.77</u> | <u>0.58</u> |
| Fully diluted | | <u>0.73</u> | <u>0.77</u> | <u>0.58</u> |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | | U.S. dollars in thousands | | |
|--|--|----------------------------------|----------------------|----------------------|
| | | 2011 | 2010 | 2009 |
| Income for the year | | 42,031 | 44,111 | 33,220 |
| Other comprehensive income - Translation differences | | <u>(5,255)</u> | <u>(452)</u> | <u>8,227</u> |
| Total comprehensive income for the Year | | <u><u>36,776</u></u> | <u><u>43,659</u></u> | <u><u>41,447</u></u> |

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

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| Note | Ordinary shares | Capital surplus | Translation differences | Retained earnings | Cost of company shares held by subsidiary | Total | |
|---|--------------------|--------------------|----------------------------|----------------------|---|---------|------------------------------|
| | | | | | | | U . S . dollars in thousands |
| BALANCE AT 1 JANUARY 2009 | 16,490 | 95,802 | 9,836 | 159,502 | (3,370) | 278,260 | |
| Comprehensive income: | | | | | | | |
| Income for the year | - | - | - | 33,220 | - | 33,220 | |
| Other comprehensive income- | | | | | | | |
| Translation differences | 2c | - | 8,227 | - | - | 8,227 | |
| Total comprehensive income for the year | | - | 8,227 | 33,220 | - | 41,447 | |
| Plan for allotment of Company shares to employees of subsidiary: | 2r | - | - | - | - | - | |
| Purchase of Company shares by subsidiary | | | | | (517) | (517) | |
| Receipts in respect of allotment of Company shares to employees | 12b | - | - | - | 470 | 470 | |
| Allotment of shares and options to senior employees: | 12b | | | | | | |
| Proceeds on allotment of Company shares to senior employees | | 107 | 485 | - | - | 592 | |
| Recognition of compensation related to employee stock and option grants | | - | 708 | - | - | 708 | |
| Dividend paid | 12c | - | - | (2,485) | - | (2,485) | |
| | | 107 | 1,193 | (2,485) | (47) | (1,232) | |
| BALANCE AT 31 DECEMBER 2009 | | 16,597 | 96,995 | 18,063 | 190,237 | (3,417) | 318,475 |

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

FRUTAROM INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| Note | Ordinary shares | Capital surplus | Translation differences | Retained earnings | Cost of company shares held by subsidiary | Total |
|---|---------------------------|-----------------|-------------------------|-------------------|---|----------------|
| | U.S. dollars in thousands | | | | | |
| 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>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> |

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

FRUTAROM INDUSTRIES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Note | Year ended 31 December | | |
|--|------|----------------------------------|----------------------|----------------------|
| | | 2011 | 2010 | 2009 |
| | | U.S. dollars in thousands | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | | |
| Cash generated from operations (see Appendix) | | 47,363 | 69,692 | 96,294 |
| Income tax paid - net | | (11,788) | (7,626) | (11,434) |
| Net cash provided by operating activities | | <u>35,575</u> | <u>62,066</u> | <u>84,860</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | |
| Purchase of property, plant and equipment | | (7,835) | (8,465) | (5,397) |
| Purchase of intangibles | | (2,564) | (2,326) | (1,196) |
| Interest received | | 642 | 163 | 995 |
| Acquisition of subsidiaries - net of cash acquired | 5 | (57,963) | - | - |
| Acquisition of operations – net of cash acquired | 5 | (43,698) | - | (37,236) |
| Reimbursement in respect of acquisition of operation | 5 | 3,850 | - | - |
| Proceeds from sale of property, plant and equipment | | 289 | 807 | 1,716 |
| Proceeds from disposal of securities classified at fair value through profit or loss | | - | - | 52 |
| Net cash used in investing activities | | <u>(107,279)</u> | <u>(9,821)</u> | <u>(41,066)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | |
| Receipts from senior employees in respect of allotment of shares | | - | - | 592 |
| Interest paid | | (2,207) | (1,884) | (4,525) |
| Receipt of long-term bank loans | | 102,002 | - | 12,848 |
| Repayment of long-term bank loans | | (40,064) | (43,697) | (43,622) |
| Receipt (discharge of short-term bank loans and credit - net | | 8,201 | (2,147) | 358 |
| Purchase of Company shares by subsidiary – net of receipts in respect of the | | | | |
| Shares | | (702) | (588) | (47) |
| Dividend paid | | (3,380) | (2,733) | (2,485) |
| Net cash provided by (used in) financing activities | | <u>63,850</u> | <u>(51,049)</u> | <u>(36,881)</u> |
| INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND BANK CREDIT | | | | |
| | | (7,854) | 1,196 | 6,913 |
| Balance of cash and cash equivalents and bank credit at beginning of year | | 44,389 | 42,940 | 37,229 |
| Profits (losses) from exchange differences on cash, cash equivalents and bank credit | | (63) | 253 | (1,202) |
| BALANCE OF CASH, CASHEQUIVALENTS AND BANK CREDIT AT END OF YEAR | | | | |
| | | <u><u>36,472</u></u> | <u><u>44,389</u></u> | <u><u>42,940</u></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 | | |
|--|----------------------------------|-----------------|---------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| Cash generated from operations: | | | |
| Income before tax | 52,866 | 59,786 | 42,941 |
| Adjustments required to reflect the cash flows from operating activities: | | | |
| Depreciation and amortization | 20,612 | 18,081 | 18,224 |
| Recognition of compensation related to employee stock and option grants | 1,108 | 979 | 708 |
| Liability for employee rights upon retirement - net | 225 | 221 | (50) |
| Loss (gain) from sale of fixed assets | 17 | (508) | (256) |
| Increase (decrease) in provisions - net | 29 | (200) | (621) |
| Erosion of loans | - | (142) | (527) |
| Interest paid - net | 1,565 | 1,721 | 3,530 |
| | <u>23,556</u> | <u>20,152</u> | <u>21,008</u> |
| Operating changes in working capital: | | | |
| Decrease (increase) in accounts receivable: | | | |
| Trade | (12,035) | (5,272) | 8,807 |
| Other | (3,046) | 2,723 | 1,588 |
| Increase (decrease) in accounts payable: | | | |
| Trade | 8,342 | 2,388 | (359) |
| Other | (5,524) | (2,444) | (1,356) |
| Decrease (increase) in inventories | (16,796) | (7,641) | 23,665 |
| | <u>(29,059)</u> | <u>(10,246)</u> | <u>32,345</u> |
| Cash flows from operating activities | <u>47,363</u> | <u>69,692</u> | <u>96,294</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 130 countries to more than 14,000 clients. The Group has production facilities in Europe, North America, Israel, and Asia (see also a list of subsidiaries in Note 23); The group has 30 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 Heshai Sh 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 2011 and 2010 and for each of the three years in the period ended 31 December 2011, 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 since 1 January 2010. 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 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: | | | | |
| 2011 | 3.821 | 0.6485 | 0.7738 | 0.9407 |
| 2010 | 3.549 | 0.6461 | 0.7491 | 0.9369 |
| 2009 | 3.775 | 0.6177 | 0.6937 | 1.0294 |
| Increase (decrease) of the dollar: during the year | % | % | % | % |
| 2011 | 7.7 | 0.4 | 3.3 | 0.4 |
| 2010 | (6.0) | 4.6 | 8.0 | (9.0) |
| 2009 | (0.7) | (9.9) | (3.3) | (3.5) |
| | <u>NIS</u> | <u>Pound Sterling</u> | <u>Euro</u> | <u>Swiss Franc</u> |
| Average exchange rate during the year: | | | | |
| 2011 | 3.578 | 0.6238 | 0.7188 | 0.8853 |
| 2010 | 3.733 | 0.6468 | 0.7537 | 1.0409 |
| 2009 | 3.933 | 0.6406 | 0.7191 | 1.0859 |
| Increase (decrease) during the year: | % | % | % | % |
| 2011 | (4.2) | (3.6) | (4.6) | (14.5) |
| 2010 | (5.1) | 1.0 | 4.8 | (4.1) |
| 2009 | 9.6 | 18.2 | 5.4 | 0.3 |

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 (only in Israel). 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: 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.

Receivables

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).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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.

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;

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- 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.

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 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 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 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. There is no deep market for high quality bonds. Therefore 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.

Sales of goods

The Group manufactures and sells a range of products. Sales of goods are recognized when a Group entity has delivered goods to the client, the client has full discretion over the channel and price to sell the products, and there is no unfulfilled obligation that could affect the client's acceptance of the products. Delivery does not occur until the products have left Group's plants, the risks of obsolescence and loss have been transferred to the client, and either the client has accepted the products in accordance with the sales contract, the acceptance provisions have lapsed, or the Group has objective evidence that all criteria for acceptance have been satisfied.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The products are occasionally sold with volume discounts; customers have a right to return faulty products. Sales are recorded based on the price specified in the sales contracts, 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.

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:

| | Basic | Diluted |
|-----------------------------|---------------------|---------------------|
| | In thousands | In thousands |
| Year end 31 December | | |
| 2011 | 57,265 | 57,475 |
| 2010 | 57,262 | 57,458 |
| 2009 | 57,183 | 57,640 |

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 mandatory for reporting period commencing 1 January, 2011:

IFRS 3 (Revised) – "Business Combinations" (hereinafter IFRS 3R). These revisions are part of the IFRS improvements document issued in May 2010. The main revisions are as follows:

- A clarification that treatment of contingent proceeds in a business combination that took place prior to implementing IFRS 3R will comply with the previous version of IFRS 3 (issued 2004).
- Allowing election of the method for measuring non-controlling interest on the date of purchase at fair value or based on the relative share in the purchased net identified assets recognized. This determination will only relate to non-ownership interest that provide ownership interest in the present and entitle holders to a proportionate share of net asset of the entity upon liquidation. All other non-controlling interest elements are measured at fair value on the date of the business combination, unless another measurement basis is required under IFRS.
- The measurement provisions of IFRS 3R apply on all payment transactions that are based on shares of the purchased, either exchanged in share-based payment transactions by the purchase or not. In addition, share-based payment of the purchased are measured under IFRS 2 "Share-Based Payment" on the date of purchase.

The revisions in IFRS 3R are implemented for all annual reporting period commencing on 1 July 2010 or thereafter. The revisions are applied prospectively commencing January 1, 2011 and first time application did not have a material effect on the group's financial statements.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

a) IFRS 9 – "Financial Instruments" (hereafter – IFRS 9).

The first part of IFRS 9, dealing with the classification and measurement of financial assets, was issued in November 2009; it sets new requirements for classification and measurement of financial assets. The second part of IFRS 9, which includes guidelines on financial liability and on retiring financial instruments, was published in October 2010. The second part of IFRS 9 replaces certain parts of IAS 39 – "Financial Instruments: Recognition and Measurement" (hereafter – IAS 39), relating to classification and measurement of financial instruments.

IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. As to amounts to be recognized as above in other comprehensive income, these amounts shall not be recycled to income or loss. Nevertheless, it is allowed to transfer accumulated income or losses between equity items.

IFRS 9 and IAS 7 – "Financial Instruments: Disclosures" were amended in December 2011 (hereafter – the Amendment) to the effect that the effective application date of IFRS 9 and its transitional provisions was changed and additional disclosure requirements were added in respect of the transition (hereafter – the additional disclosures).

Both parts of IFRS 9 will apply to annual periods commencing on 1 January 2015 or thereafter. Entities can elect to early adopt IFRS 9, but it is not permitted to adopt early the second part of IFRS 9 without implementing the first part of IFRS 9 on the same date. On the other hand, it is possible to early adopt the first part of IFRS 9 without being required to implement the second part of IFRS 9 on the same date. Entities that will adopt IFRS 9 for reporting periods commencing:

1. before 1 January 2012 will not be required to modify their comparative figures upon first-time adoption and will be required to provide the additional disclosures.
2. January 1, 2012 or thereafter and before January 1, 2013 – shall be required to either modify their comparative figures or provide the additional disclosures.
3. January 1, 2013 or thereafter – shall not be required to modify their comparative figures but be required to provide the additional disclosures.

The Group is studying the expected effect on IFRS 9 on its financial statements and on the timing of its application.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

b) IFRS 10 – Consolidated Financial Statements" (hereafter – IFRS 10)

IFRS 10 replaces all of the guidance on control and consolidation in IAS 27, 'Consolidated and separate financial statements', and SIC 12, 'Consolidation – Special Purpose Entities'. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. The revised definition of control focuses on the need to have both power and variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. IFRS 10 also includes guidance on participating and protective rights and guidance relating to agent/principal relationships. An investor (the agent) may be engaged to act on behalf of a single party or a group of parties (the 'principals'). The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single entity remains unchanged, as do the mechanics of consolidation. IFRS 10 is to be implemented for annual reporting periods commencing January 1, 2013 or thereafter. Early adoption is permitted, but in doing so the entity must disclose the fact that it has early adopted the standard and also apply IFRS 11 - "Joint Arrangements" (hereafter – IFRS 11), IFRS 12 - "Disclosures of Interests in Other Entities" (hereafter – IFRS 12), IAS 27R "Separate Financial Statements" (hereafter – IAS 27R) and IAS 28R - "Investments in Associates and Joint Ventures" (hereafter – IAS 28R). The Group is studying the expected effect of IFRS 10 on its financial statements and the timing of its application.

c) IFRS 12

IFRS 12 sets disclosure requirements for accounting matters covered by IFRS 10 and IFRS 11 and replaces the disclosure requirements in IAS 28. Disclosure requirements set in IFRS 12 concern the following areas: significant judgments and assumptions, interest in subsidiaries, interest in joint arrangements and associates and interest in unconsolidated structured entities. The standard is effective for annual periods beginning on or after 1 January, 2013, with earlier application permitted. An entity can provide any or all of the above disclosures without having to apply IFRS 12 in its entirety, or IFRS 10 or 11, or the amended IAS 27 or 28. The Group is studying the expected effect of IFRS 12 on its financial statements and the timing of its application.

d) IFRS 13 – "Fair Value Measurement"

IFRS 13, 'Fair value measurement', aims to improve consistency and reduce complexity of fair value measurement by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs. IFRS 13 is to be applied to annual reporting period commencing on January 1, 2013 or thereafter. Early adoption is permitted, provided that the fact that the standard is early adopted is disclosed. IFRS 13 is applied prospectively commencing the beginning of the annual reporting period in which it is applied for the first time. It is not required to apply the disclosure requirements set in IFRS 13 to comparative figures relating to periods prior to first time application of the standard. The Group is studying the expected effect of IFRS 13 on its financial statements and the timing of its application.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

e) IAS 19 – "Employee Benefits" (hereafter – IAS 19 Amendment)

The amendment to IAS 19 makes 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:

- "Actuarial gains and losses" are renamed "re-measurements" and will be recognized immediately in OCI. 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 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 amendment is effective for periods beginning on or after 1 January 2013. Earlier application is permitted. The amendment should be applied retrospectively, except for:

- a) An entity needs not to adjust the carrying amount of assets outside the scope of IAS 19 (2011) for changes in employee benefits costs that were included in the carrying amount before the date of initial application of the amendment.
- b) Comparative information for the disclosures required in the amendment to IAS 19 about the sensitivity of the defined benefit obligation will not needed in financial statements for periods beginning before January 1, 2014.

The Group is studying the expected effect of IAS 19 on its financial statements and the timing of its application.

- f) 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 (hereafter – OCI) 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 OCI 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.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- Entities electing to present OCI 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 amendment to IAS 1 will be applied to annual reporting periods commencing 1 July, 2012 or thereafter, with full retrospective application. Early adoption is permitted. The Group is studying the timing of application of the Amendment to IAS 1. Nevertheless, Group management is of the opinion that the first time application is not expected to have a material effect on the financial statements of the Group.

- g) Amendment to IFRS 7 – "Financial Instruments: Disclosures" (hereafter – the Amendment to IFRS 7), which was issued in October 2010. The Amendment to IFRS 7 expands the disclosure requirements with regard to financial assets that were transferred to another party but are still included in the Company's statement of financial position, and the associated liabilities (including the connection between the said assets and liabilities). In addition, the Amendment to IFRS 7 also enhances the disclosure requirements regarding financial assets that were derecognized, but in respect of which there is an exposure to certain risks and rewards relating to the transferred assets.

The Amendment to IFRS 7 shall be applied to annual reporting periods commencing on July 1, 2011 or thereafter; early adoption is permitted. The Group intends to apply the Amendment to IFRS 7 commencing January 1, 2012. The first time application is not expected to have a material effect on the Group's financial statements.

- h) Amendment to IAS 32 – "Offsetting of Financial Assets and Financial Liabilities" (hereafter – Amendment to IAS 32) and Amendment to IFRS 7 – "Disclosures – Offsetting of Financial Assets and Financial Liabilities" (hereafter – Amendment to IFRS 7), which were issued in December 2011. The Amendment to IAS 32 does not change the existing model as part of IAS 32 – "Financial Instruments: Presentation" regarding offsetting of financial assets and financial liabilities (hereafter –offsetting); however, it clarifies that the right to set-off must be available today and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy of the entity or any of the counterparties. The Amendment to IAS 32 also clarifies the cases where offsetting using gross settlement mechanisms will satisfy the criteria for offsetting by gross net settlement. The Amendment to IFRS 7 adds disclosure requirements that focus on quantitative information about recognized financial instruments that are offset in the statement of financial position, as well as those recognized financial instruments that are subject to certain offsetting arrangements (irrespective of whether they are offset in the statement of the financial position).

The Amendment to IAS 32 will be applied retrospectively for annual reporting periods commencing on January 1, 2014 or thereafter; early adoption is permitted.

The Amendment to IFRS 7 will be applied retrospectively for annual reporting periods commencing on January 1, 2013 or thereafter and for interim reporting period within the said annual reporting periods.

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:

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 Treasury monitors total global exposure with the help of comprehensive data received on a quarterly basis.

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 2011, 2010 and 2009, if the U.S. dollar had weakened/strengthened by 1% against the currencies referred to below with all other variables unchanged:

| | 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 |
| | | | | |
| | 31 December 2009 | | | |
| | U.S. dollars in thousands | | | |
| | NIS | Pound sterling | Euro | Swiss Franc |
| Financial asset/liabilities, net | 4,178 | (76) | 5,562 | (2,948) |
| Exchange gains/losses: | | | | |
| Impact of 1% strengthening | (32) | 1 | (43) | 23 |
| Impact 1% weakening | 32 | (1) | 43 | (23) |

* 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 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>U.S. dollars in thousands</u> | | | | | | |
| 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 U.K., Italy, Belgium, Germany 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.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Monetary balances denominated in various currencies included in the Company's consolidated statement of financial position at 31 December 2010, 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>U.S. dollars in thousands</u> | | | | | | |
| Assets: | | | | | | | |
| Current assets: | | | | | | | |
| Cash and cash equivalents | 15,296 | 1,253 | 5,687 | 13,147 | 5,823 | 3,183 | 44,389 |
| Accounts receivable: | | | | | | | |
| Trade | 16,176 | 9,561 | 4,846 | 25,358 | 5,426 | 8,453 | 69,820 |
| Other | 4,826 | 3,575 | 549 | 961 | 824 | 101 | 10,836 |
| | <u>36,298</u> | <u>14,389</u> | <u>11,082</u> | <u>39,466</u> | <u>12,073</u> | <u>11,737</u> | <u>125,045</u> |
| Liabilities: | | | | | | | |
| Current liabilities: | | | | | | | |
| Short-term bank borrowings and loans | - | - | - | 113 | - | - | 113 |
| Accounts payable: | | | | | | | |
| Trade | 5,055 | 6,494 | 2,989 | 11,165 | 3,842 | 835 | 30,380 |
| Other | 2,172 | 5,801 | 5,959 | 9,467 | 6,910 | 1,323 | 31,632 |
| Non-current liabilities: | | | | | | | |
| Long-term loans | 5,250 | - | 15,825 | 43,123 | - | 19 | 64,217 |
| | <u>12,477</u> | <u>12,295</u> | <u>24,773</u> | <u>63,868</u> | <u>10,752</u> | <u>2,177</u> | <u>126,342</u> |

Some of the balances are included in the statements of financial position of the consolidated companies in the U.K., Belgium, Germany and Switzerland whose 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):

3) 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 2011 of a 0.1% shift in interest rate on loans would have been a change of \$ 79 thousand (2010 - \$63 thousand; 2009- \$94 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.

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 guidelines.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The table presented below classifies the Group's financial liabilities into relevant maturity groupings based on the remaining period at 31 December 2011 to the contractual maturity date. Group entities do not have derivative financial liabilities. The amounts presented in the table represent the contractual 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 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> |
| As of 31 December 2010: | | | |
| Borrowings | 33,412 | 32,405 | - |
| Accounts payable and accruals | 62,012 | - | - |
| | <u>95,424</u> | <u>32,405</u> | <u>-</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 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 2011 and 2010 were as follows:

| | 2011 | 2010 |
|--|--------------------------------------|----------------|
| | U.S. dollars in thousands | |
| Total borrowings (Note 9) | 141,646 | 64,330 |
| Less - cash and cash equivalents (Note 18) | (36,472) | (44,389) |
| Net debt | <u>105,174</u> | <u>19,941</u> |
| Total equity | 393,594 | 359,792 |
| Total capital | <u>498,768</u> | <u>379,733</u> |
| Gearing ratio | <u>21.1%</u> | <u>5.3%</u> |

The increase in the Gearing ratio during 2011 is attributed to loans received for the purpose of financing the acquisitions made during the reported year.

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 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.

The assumption regarding the expected yield on severance pay funds is determined uniformly in accordance with long-term historical yields.

The assumption regarding the required rate of discount is determined by the external actuaries at the end of each year. This rate of discount shall be used in determining the estimated updated value of the future cash flows that would be required to cover the severance pay liabilities. The liquidity of the market of high-quality corporate bonds is sufficient to serve as basis for determining the rate of discount. Therefore, in determining this rate the Group uses interest rate in the currency in which the benefits will be paid.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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 Oxford Chemicals Limited

On 30 January 2009, the Group acquired the operations of Oxford Chemicals Limited (hereafter- Oxford). Oxford is a UK resident company engaged in the development, manufacture and marketing of unique raw materials for the flavor and fragrances industry.

The consideration paid in cash in respect of the acquisition was £8,250 thousand (U.S.\$11,734 thousand); the acquisition was financed by a long-term loan.

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

The cost of acquisition presented in these financial statements includes acquisition costs. The cost of acquisition amounts to £8,630 thousand (U.S.\$12,274 thousand).

The intangible assets that were recognized include: products formulas at the total amount of £697 thousand (U.S.\$991 thousand), customer relationships at the total amount of £871 thousand (U.S.\$1,239 thousand) and goodwill at the total amount of £3,751 thousand (U.S.\$5,335 thousand).

The products formula and customers relationship are amortized over an economic life of 20 years and 10 years, respectively. The goodwill is not amortized on a current basis, but tested annually for impairment.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Assets and liabilities of Oxford at the date of the acquisition:

| | Fair value | Value of acquired operations in Oxford's books of accounts |
|-------------------------------|---------------------|---|
| | U.S. dollars | in thousands |
| Current assets: | | |
| Accounts receivable: | | |
| Trade | 1,724 | 1,724 |
| Other | 188 | 188 |
| Inventories | 2,112 | 2,364 |
| Non-current assets: | | |
| Property, plant and equipment | 2,792 | 2,792 |
| Intangible assets | 2,230 | - |
| Goodwill | 5,335 | - |
| Current liabilities: | | |
| Accounts payable: | | |
| Trade | (1,182) | (1,182) |
| Other | (532) | (532) |
| Deferred income taxes | (393) | - |
| | *12,274 | 5,354 |

* Not including additional acquisition costs of £ 380 thousands (U.S. \$540 thousands).

The acquired operations are synergetic to the Group's existing raw materials operations in England, Israel, USA and other countries.

b. Acquisition of Flavor Specialties Inc.

On 4 March 2009, the Group acquired the operations of the U.S. company Flavors Specialties Inc. (hereafter – FSI).

FSI is a company engaged in the development, production and marketing of flavor extracts and botanical extracts, mainly for the food and beverages industries.

The consideration paid in cash in respect of the acquisition was \$17,223 thousand; the acquisition was financed by bank credit.

The purchase agreement stipulates a mechanism for the payment of a future consideration based on the average EBITDA achieved by FSI in the course of the 24 months ending 31 December 2010.

In accordance with the said mechanism, in 2011, the Company received a refund of \$ 3.85 million.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

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

The cost of acquisition presented in these financial statements, which include acquisition costs, amount to \$13,737 thousand.

The intangible assets that were recognized include: products formulas at the total amount of U.S. \$2,337 thousand, customer relationships at the total amount of U.S. \$1,147 thousand and goodwill at the total amount of U.S. \$7,043 thousand.

The products formula and customers relationship are amortized over an economic life of 20 years and 7 years, respectively. The goodwill is not amortized on a current basis, but tested annually for impairment.

Assets and liabilities of FSI at date of acquisition:

| | <u>Fair value</u> | <u>Value of acquired operations in FSI's books of accounts</u> |
|-------------------------------|---------------------|--|
| | <u>U.S. dollars</u> | <u>in thousands</u> |
| Current assets: | | |
| Accounts receivable: | | |
| Trade | 1,314 | 1,314 |
| Other | 13 | 13 |
| Inventories | 1,515 | 1,515 |
| Non-current assets: | | |
| Property, plant and equipment | 590 | 590 |
| Intangible assets | 3,484 | - |
| Goodwill | 7,043 | - |
| Current liabilities : | | |
| Accounts payable trade | (222) | (222) |
| | <u>*13,737</u> | <u>3,210</u> |

* Not including additional acquisition expenses in the total amount of \$235 thousand and a \$3,721 thousand debt balance for acquiring the operations.

The acquired operations are synergetic to the Group's existing flavors operations in USA and were fully merged with the existing operations.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

c. Acquisition of the savoury operation of the Christian Hansen Group

On June 18, 2009, the Group acquired the savoury (non-sweet) operations in Germany of the Christian Hansen group (hereafter – "CH").

The savoury operations of CH involve development, production, and marketing savoury flavour products such as flavour concentrates, spice mixes, and functional raw materials for the food industry, particularly the meat industry and convenience food.

The consideration paid in cash in respect of the acquisition was € 5,275 thousand (\$7,354 thousand) and the acquisition was financed out of Group's equity.

The cost of acquisition was allocated to tangible assets and intangible assets (except for goodwill) based on their fair value at the date of acquisition and to goodwill.

The cost of acquisition presented in these financial statements (including acquisition costs) amounts to € 5,425 thousand (\$7,563 thousand).

The intangible assets that were recognized include: products formulas at the total amount of € 335 thousand (\$467 thousand), customer relationships at the total amount of € 339 thousand (\$473 thousand) and goodwill at the total amount of € 3,005 thousand (\$4,190 thousand).

The products formula and customers relationship are amortized over an economic life of 20 years and 10 years, respectively.

The goodwill is not amortized on a current basis, but tested annually for impairment.

Assets and liabilities of CH at date of acquisition:

| | Fair value | Value of acquired operations in CH's books of accounts |
|-------------------------------|---------------------|---|
| | U.S. dollars | in thousands |
| Current assets: | | |
| Accounts receivable- other | 74 | - |
| Inventories | 1,097 | 1,171 |
| Non-current assets: | | |
| Property, plant and equipment | 1,181 | 1,372 |
| Intangible assets | 940 | - |
| Goodwill | 4,190 | - |
| Deferred income taxes | 81 | - |
| | <u>*7,563</u> | <u>2,543</u> |

* Not including additional acquisition expenses in the total amount of € 150 thousand (\$209 thousand).

The acquired operation is synergetic to the Group's savory operation in Germany and was merged into the existing savory operation.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

d. 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 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.

In 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> |

The acquired operations generated revenue of \$ 6,271 thousands and net income (after acquisition costs) of \$ 342 thousands for the period from the acquisition date through December 31, 2011.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

e. 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, 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.

Assets and liabilities of EAFI at date of acquisition:

| | <u>Fair value</u> <u>U.S. dollars in</u> <u>thousands</u> |
|---|---|
| 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) |
| | <u>4,834</u> |

The acquired operations generated revenue of \$ 8,984 thousands and net income (after acquisition costs) of \$ 240 thousands, for the period from the acquisition date through December 31, 2011.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

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

On 25 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.

The Group works to merge 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).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

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 |

The acquired operations generated revenue of \$ 8,576 thousands and net income of \$ 428 thousands (after deduction of one time acquisition expenses of \$ 1,252 thousands, net loss of \$ 465 thousands), for the period from the acquisition date through December 31, 2011.

g. 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.

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.

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 £2,044 thousand (\$3,354 thousand), customer relations at £2,895 thousand (\$4,750 thousand) and goodwill at £9,828 thousand (\$16,127 thousand).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

Assets and liabilities of Aromco at the date of acquisition:

| | <u>Fair value</u> <u>U.S. dollars in</u> <u>thousands</u> |
|---------------------------------|---|
| 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) |
| | <u>24,614</u> |

The acquired operations generated revenue of \$ 5,876 thousand and net income (after acquisition costs) of \$ 1,298 thousand, for the period from the acquisition date through 31 December 2011.

h. 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.

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, with high production capacity. 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 synergetic to the operations of Flavor Specialties in Corona, California, which was purchased by the group in 2009.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

The final price of the transaction will be 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 \$44.8 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.

The cost of acquisition presented in these financial statements amounts to \$ 34,787 thousands, with the addition of a contingent consideration of \$ 10,000 thousands (capitalized value \$ 9,793 thousands) in accordance with the adjustment mechanism set in the acquisition agreement; the two amounts total \$44,580 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. The fair value of the acquired assets and liabilities is subject to a final purchase price allocation analysis commissioned by the Company; this analysis has not yet been completed as of the date of approving these financial statements.

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 | 28,602 |
| Product formulas | 6,886 |
| Customer relations | 7,247 |
| Current liabilities : | |
| Accounts payable and accruals | (1,101) |
| Short term bank credit | (195) |
| Others creditors | (729) |
| Deferred income taxes | (288) |
| Long-term loans | (10,368) |
| | <u>44,580</u> |

The acquired operations generated revenue of \$ 5,052 thousand and net income (after acquisition costs) of \$ 178 thousand, for the period from the acquisition date through 31 December 2011.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – BUSINESS COMBINATIONS (continued):

i. Fully year proforma data

The summary of unaudited proforma data presented below represents the data of the Group under the assumption that the businesses that were acquired in the course of the year ended December 31, 2011 were acquired on January 1, 2011. The proforma amounts include the results of the acquired companies, the amortization of the intangible assets that were purchased and recognized upon acquisition and the interest expenses relating to a debt accrued as a result of the acquisition. The proforma amounts do not include the effect of the synergy that might arise as a result of the acquisition. The proforma data are presented for comparison purposes only and do not necessarily represent the actual results that might have arisen. Also, these data do not give any indication on the future results of operations of the combined companies.

| | 2011 |
|---|--------------------------------------|
| | U.S. dollars in thousands |
| Revenue | 556,417 |
| Net income | 44,121 |
| Add - one-time acquisition expenses (net of tax) | 1,340 |
| Net income before deduction of one-time acquisition expenses | 45,461 |

In the period commencing date of acquisition through December 31, 2011, the acquired companies have contributed to the Group revenues of \$ 34,758 thousands and net income (before deduction of one- time acquisition expenses) of \$ 2,933 thousands (net income of \$ 1,593 thousands including one- time acquisition expenses).

The results of the new acquisitions for the period from January 1, 2011 through December 31, 2011, under the proforma assumptions presented above were as follows: sales of \$ 72,732 thousands and net income of \$ 5,023 thousands (before deduction of one- time acquisition expenses).

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, which is incorporated as a separate company in Israel (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 to customers in Israel. These operations are the basis on which the Group reports its primary segment information.

Segment data provided to the President and CEO in respect of the reported segments for the year ended December 31, 2011 is as follows:

| | <u>Flavors operations</u> | <u>Fine ingredients operations</u> | <u>Trade and marketing operations</u> | <u>Eliminations</u> | <u>Total Consolidated</u> |
|--|-------------------------------|--|---|---------------------|-------------------------------|
| | 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> | <u>58,664</u> |
| Financial expenses – net | | | | | 5,798 |
| Taxes on income | | | | | 10,835 |
| Net income | | | | | <u>42,031</u> |

Segment data provided to the President and CEO in respect of the reported segments for the year ended December 31, 2010 is as follows:

| | <u>Flavors operations</u> | <u>Fine ingredients operations</u> | <u>Trade and marketing operations</u> | <u>Eliminations</u> | <u>Total Consolidated</u> |
|--|-------------------------------|--|---|---------------------|-------------------------------|
| | 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> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – SEGMENT REPORTING (continued):

Segment data provided to the President and CEO in respect of the reported segments for the year ended 31 December 2009 is as follows:

| | <u>Flavors operations</u> | <u>Fine ingredients operations</u> | <u>Trade and marketing operations</u> | <u>Eliminations</u> | <u>Total Consolidated</u> |
|--|-------------------------------|--|---|---------------------|-------------------------------|
| | U.S. dollars in thousands | | | | |
| Income statement data: | | | | | |
| Sales – net: | | | | | |
| Unaffiliated customers | 297,062 | 121,043 | 7,074 | - | 425,179 |
| Intersegment | - | 2,735 | - | (2,735) | - |
| Total sales and other operating income | <u>297,062</u> | <u>123,778</u> | <u>7,074</u> | <u>(2,735)</u> | <u>425,179</u> |
| Segment results | <u>37,712</u> | <u>9,193</u> | <u>480</u> | <u>(100)</u> | <u>47,285</u> |
| Financial expenses - net | | | | | 4,344 |
| Taxes on income | | | | | 9,721 |
| Net income | | | | | <u>33,220</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 30 research and development laboratories and sells and markets its products principally through its 50 sales and marketing offices.

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

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 | | |
|---|---------------------------|----------------|----------------|
| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| | U.S. dollars in thousands | | |
| EMEA** | 228,396 | 183,921 | 180,266 |
| Germany | 84,219 | 76,946 | 73,087 |
| Switzerland | 46,623 | 45,923 | 45,371 |
| America | 60,257 | 55,970 | 49,718 |
| Israel* | 43,895 | 39,596 | 37,079 |
| Asia | 55,053 | 48,710 | 39,658 |
| | <u>518,443</u> | <u>451,066</u> | <u>425,179</u> |
| *Including trade and marketing operations | <u>6,373</u> | <u>5,425</u> | <u>7,074</u> |

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

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

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 2010 is as follows :

| | Cost | | | | Accumulated depreciation | | | | Depreciated balance 31 December 2010 | | |
|---|------------------------------------|---------------------------------|-----------------------------------|--------------|------------------------------|------------------------------------|---------------------------------|-----------------------------------|---|----------------|------------------------------|
| | 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 | 60,712 | 1,034 | (1,308) | 1,989 | 62,427 | 9,778 | 2,084 | (1,284) | 120 | 10,698 | 51,729 |
| Machinery and equipment | 118,068 | 5,310 | (993) | 756 | 123,141 | 68,141 | 6,669 | (948) | 1,340 | 75,202 | 47,939 |
| Vehicles and lifting Equipment | 4,344 | 518 | (482) | 33 | 4,413 | 2,390 | 513 | (319) | 9 | 2,593 | 1,820 |
| Furniture and office equipment (including computers) | 31,713 | 1,474 | (155) | 790 | 33,822 | 14,835 | 1,649 | (88) | (929) | 15,467 | 18,355 |
| Leasehold improvements | 13,001 | 129 | - | (964) | 12,166 | 5,145 | 1,092 | - | (350) | 5,887 | 6,279 |
| | <u>227,838</u> | <u>8,465</u> | <u>(2,938)</u> | <u>2,604</u> | <u>235,969</u> | <u>100,289</u> | <u>12,007</u> | <u>(2,639)</u> | <u>190</u> | <u>109,847</u> | <u>126,122</u> |

* Arising 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, 2011, in respect of the said lands, amount to\$ 173 thousands (2010 - \$1,205 thousand, 2009 -\$1,237 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) In 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 \$ 305 thousands.
- 3) A subsidiary in China has “Land Use Rights” on land in China. The rights are for a period of 50 years ending in 2046. Net capitalised lease fees as at December 31, 2011, in respect of the said land, amount to 183 thousand (2010 - \$ 191 thousand; 2009 - \$199 thousand).

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>2011</u> | <u>2010</u> | <u>2009</u> | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| | U.S. dollars in thousands | | | | | |
| Know-how and product formulas | 48,596 | 34,376 | 35,645 | 37,611 | 25,427 | 28,255 |
| Goodwill | 180,656 | 128,109 | 136,522 | 179,428 | 126,879 | 135,262 |
| Customer relations | 41,765 | 25,068 | 26,469 | 29,982 | 16,046 | 19,703 |
| Trademarks | 219 | 220 | 230 | 105 | 116 | 133 |
| Computer software | 17,877 | 15,565 | 12,710 | 8,584 | 8,668 | 7,792 |
| | <u>289,113</u> | <u>203,338</u> | <u>211,576</u> | <u>255,710</u> | <u>177,136</u> | <u>191,145</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.S. dollars | <u>Customer relations</u> in thousands | <u>Trademarks</u> | <u>Total</u> |
|--|------------------------------|---|----------------------------------|---|-------------------|----------------|
| Balance as of 1 January 2009 - net | 8,045 | 24,899 | 114,582 | 18,427 | 130 | 166,083 |
| Changes in year ended 31 December 2009: | | | | | | |
| Acquisitions | 1,145 | 51 | - | - | - | 1,196 |
| Changes in the excess of cost of acquisition | - | - | (1,166) | - | - | (1,166) |
| Adjustment arising from acquisition of consolidated companies and operations | - | 3,795 | 16,568 | 2,859 | - | 23,222 |
| Exchange differences | 151 | 1,138 | 5,278 | 867 | 14 | 7,448 |
| Annual amortization charge (Note 2f) | (1,549) | (1,628) | - | (2,450) | (11) | (5,638) |
| Closing net book amount | <u>7,792</u> | <u>28,255</u> | <u>135,262</u> | <u>19,703</u> | <u>133</u> | <u>191,145</u> |
| Changes in year ended 31 December 2010: | | | | | | |
| Acquisitions | 2,326 | - | - | - | - | 2,326 |
| Exchange differences | 307 | (1,044) | (8,383) | (1,135) | (6) | (10,261) |
| Annual amortization charge (Note 2f) | (1,757) | (1,784) | - | (2,522) | (11) | (6,074) |
| Closing net book amount | <u>8,668</u> | <u>25,427</u> | <u>126,879</u> | <u>16,046</u> | <u>116</u> | <u>177,136</u> |
| Changes in year ended 31 December 2011: | | | | | | |
| 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> |

* Goodwill as of 31 December 2011 is allocated to the Flavor segment in the U.K., Germany, Israel, Norway, Italy and in the USA 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 | |
|------------------------|----------------------------------|----------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Cash-generating unit 1 | 97,915 | 88,844 |
| Cash-generating unit 2 | 25,694 | 10,580 |
| Cash-generating unit 3 | 6,574 | 6,791 |
| Cash-generating unit 4 | 5,784 | 5,805 |
| Cash-generating unit 5 | 7,043 | 7,043 |
| Cash-generating unit 6 | 2,699 | 2,699 |
| Cash-generating unit 7 | 2,619 | 2,619 |
| Cash-generating unit 8 | 2,498 | 2,498 |
| Cash-generating unit 9 | 28,602 | - |
| Total | 179,428 | 126,879 |

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 and purchase price adjustments 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 discount rate taken into account in the calculation is 16.4% before taxes.

Group management determined gross margins 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 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 would not be 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 | |
|---------------------------------------|--------------------------------------|----------------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Non current borrowings | 88,947 | 32,028 |
| Current borrowings: | | |
| Current maturities of long-term loans | 47,938 | 32,189 |
| Bank borrowings | 4,761 | 113 |
| | <u>52,699</u> | <u>32,302</u> |
| Total borrowings | <u><u>141,646</u></u> | <u><u>64,330</u></u> |

Bank borrowings as of December 31, 2011 mature until 2015 and bears average interest of 2.47% according to the current Libor rates.

The exposure of the Group's cash flows to interest rate changes at the balance sheet dates is dependent at the rate of Libor-Euro, Libor-Dollar, and Libor-Pound Sterling and it is updated on a 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 | |
|------------------|---|----------------------------------|---------------|
| | | 2011 | 2010 |
| | | U.S. dollars in thousands | |
| Pound sterling | 2.84% | 34,073 | 15,823 |
| Dollars | 1.66% | 49,403 | 5,250 |
| Euro | 2.95% | 58,152 | 43,238 |
| Other currencies | 2.00% | 18 | 19 |
| | | <u>141,646</u> | <u>64,330</u> |

* Interest rates for 2011.

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

| | 2011 | 2010 |
|-------------|----------------------------------|---------------|
| | U.S. dollars in thousands | |
| Second year | 65,462 | 28,528 |
| Third year | 16,941 | 3,500 |
| Fourth year | 6,544 | - |
| | <u>88,947</u> | <u>32,028</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 2011, 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. The Israeli companies' liability is covered mainly by regular contributions in defined contribution plans. The amounts funded as above are not reflected in the balance sheets since they are not under the control and management of the companies.
- b.** Under the agreement with its employees, the U.S. subsidiary financed a defined benefit plan. As part of the collective agreement signed between the Company's subsidiary and the industrial labour union on 13 October, 2000, the U.S. subsidiary suspended the said plan and joined, as from that date, a comprehensive pension plan of the labour union, which is a defined contribution plan.
The U.S. subsidiary will continue financing its existing liabilities under the suspended pension plan. The amount of liability for employee rights upon retirement and amounts funded, as presented in the consolidated accounts, reflect, 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.
- d.** The following amounts related to employee remuneration and benefits are included in determining operating profit:

| | Year ended December 31 | | |
|---|----------------------------------|----------------|---------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| Wages and salaries | 98,641 | 84,289 | 83,580 |
| Social security costs | 11,669 | 9,793 | 9,740 |
| Post-employment benefits: defined benefit plans | 2,144 | 1,880 | 1,500 |
| Post-employment benefits: defined contribution plans | 1,996 | 2,134 | 2,196 |
| Termination benefit expenses | 850 | 1,431 | 1,296 |
| Compensation under stock option plans and other employee benefits | 1,108 | 979 | 708 |
| Total employees' benefits | 116,408 | 100,506 | 99,020 |

At year-end, the Group employed 1,644 people (1,472 people and 1,448 people, respectively, in 2010 and 2009).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

| | Year ended December 31 | | |
|--|----------------------------------|--------------|--------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| Current service cost | 1,528 | 1,310 | 1,196 |
| Interest cost | 1,496 | 1,522 | 1,639 |
| Actual return on plan assets – U.S. subsidiary | (171) | (160) | (143) |
| Expected return on plan assets – Swiss and German consolidated companies | (852) | (832) | (1,283) |
| Net actuarial losses (gains) recognized during the year | 143 | 40 | 91 |
| Total included in payroll expenses | <u>2,144</u> | <u>1,880</u> | <u>1,500</u> |

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 | |
|--|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| At 1 January | 11,242 | 11,605 |
| Total expenses included in employees' remuneration | 2,144 | 1,880 |
| Benefits paid | (1,899) | (1,659) |
| Currency translation effects and others | (128) | (584) |
| At 31 December | <u>11,359</u> | <u>11,242</u> |

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

| | December 31 | |
|---|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Present value of obligations arising from fully or partially funded plans | 48,623 | 49,247 |
| Fair value of plan assets | (32,480) | (33,368) |
| Excess of the present value of funded liability over plan assets | 16,143 | 15,879 |
| Unrecognised actuarial losses | (4,784) | (4,637) |
| Balance of liability recognized in the statement of financial position | <u>11,359</u> | <u>11,242</u> |

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.

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 | | |
|---|--------|-------|-------|---------|-------|-------|-------------|-------|-------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| Discount rates | 5.15% | 5.7% | 6.25% | 4.77% | 4.85% | 5.10% | 2.3% | 2.75% | 3.25% |
| Projected rates of payroll raise | | | | 1.16% | 1.16% | 1.20% | 2.0% | 2.5% | 2.00% |
| Expected rates of return on plan assets | 7.25% | 7.25% | 7.25% | 5.03% | 5.64% | 5.60% | 2.5% | 2.75% | 3.50% |

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 2011 and 2017.

Minimum lease commitments of the Group under the above leases, at rates in effect on 31 December 2011, are as follows:

| Year ending 31 December: | <u>\$ in thousands</u> |
|--------------------------|------------------------|
| 2012 | 5,023 |
| 2013 | 2,886 |
| 2014 | 1,988 |
| 2015 | 1,657 |
| 2016 | 1,652 |
| 2017 | 1,578 |
| | <u>14,784</u> |

Rental expenses totaled \$ 4,673 thousand, \$ 4,528 thousand \$ 4,640 thousand, in the years ended 31 December 2011, 2010 and 2009, 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 2011 is \$1,098 thousand.

In 2011, 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 \$158 thousand (2010 - \$337 thousand); therefore it carried this amount to income.

b. Contingent Liabilities:

1) Reimbursement of expenses arising from raise of capital

As part of a capital raise made by the Company in the London Stock Exchange (see note 12b), the Company and the Bank of New York (hereafter – the bank) signed, in February 2005, an agreement, whereunder the bank would allocate the GDRs issued in the LSE as part of the above capital raise, and would provide services to the Company and to the holders of the GDRs listed in the official list of the UK Listing Authority. In consideration for the right to provide services as above, the bank paid the Company \$810 thousand and also undertook to bear further expenses of up to \$270 thousand, relating to quoting the GDRs in future years.

Under the said agreement, the Company might be required to reimburse the expenses paid by the bank (with the addition of \$500 thousand) if one of the suspending conditions of the agreement, which pertain to cease of quoting the GDRs, the reduction of such quoting, or a change in ownership, is met. Under the agreement, such reimbursement of expenses might be required for a seven-year period, commencing the date of capital raise. The Company recognizes the amounts received from the bank as revenues over the period during which the service is rendered. The said agreement is to terminate in February 2012.

2) 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 an addendum to the environmental agreement, whereunder 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 | |
| | 2011 | 2010 |
| Authorized | 100,000 | 100,000 |
| Issued and paid | 57,826 | 57,826 |

Company listed shares are quoted on the TASE at NIS 33.9 (\$8.87) per share as of December 31, 2011. The GDRs representing the Company's shares are quoted on the official list of the LSE.

- 2) Ordinary Company shares of NIS 1 par value, are held by a subsidiary and included in the issued and paid share capital constitute 1% (576,283 shares) and 0.94% (545,417 shares) of the balance of ordinary issued and paid shares of this type as of 31 December 2011 and 2010, respectively.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

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

- 1) In 1996, the Company’s Board of Directors approved an employee stock purchase plan (the “1996 Plan”), whereunder a subsidiary purchases Company shares in the TASE, for the purpose of granting the shares to senior employees of the Group. The 1996 plan was replaced in 2003 by the 2003 plan (hereinafter - the 2003 plan).

The rights to purchase the shares (hereafter – the options) are granted to senior employees twice a year. The senior employees have the right to exercise the options they were granted at the end of the vesting period. The vesting period of the shares granted under this plan is spread over three equal, annual batches: one year, two years and three years from date of grant.

In any event, an employee’s options, as above, expire six years from the date such they are granted.

The exercise price per option is 33.3% of the average price paid by the subsidiary upon purchase of Company shares in a given grant.

The theoretical economic value of the options in respect of grants from 2006 through 2011, the recognition of the benefits in respect of which has not yet been completed, is based on the following assumptions: expected dividend yield of 0% for all years (since the employees are also entitled to receive a dividend); expected volatility of 26.79%-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.

The 2003 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 2003 Plan, which have not yet been exercised by Company employees, as of December 31, 2011:

| <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> |
|----------------------|---|---|------------------------------------|
| 2006 | 1,548 | - | 2.7-2.92 |
| 2007 | 28,715 | - | 2.81 – 2.99 |
| 2008 | 57,437 | - | 2.75 – 2.99 |
| 2009 | 72,509 | 46,485 | 2.59 – 2.70 |
| 2010 | 41,939 | 97,332 | 3.08 – 3.15 |
| 2011 | - | 71,377 | 3.34 |
| | <u>202,148</u> | <u>215,194</u> | |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

As of December 31, 2011, 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 \$520 thousand. The said remaining compensation will be charged to income using the accelerated method over the remaining vesting period.

As to shares granted to a manager in the Company - Note 21.a.2.

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

| | 2011 | | 2010 | | 2009 | |
|---------------------------------|---|----------------|---|----------------|---|----------------|
| | 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 | 3.10 | 424,098 | 2.80 | 445,332 | 2.85 | 551,289 |
| Granted | 3.59 | 73,348 | 3.18 | 161,277 | 2.79 | 169,311 |
| Forfeited | 3.07 | (17,481) | 2.86 | (46,440) | 2.70 | (102,839) |
| Exercised | 2.88 | (62,623) | 2.77 | (136,071) | 2.73 | (172,429) |
| Balance at 31 December | <u>2.97</u> | <u>417,342</u> | <u>3.10</u> | <u>424,098</u> | <u>2.80</u> | <u>445,332</u> |

The following table summarizes information about exercise price and the contractual terms of options outstanding at December 31, 2011:

| Exercise Prices | Share rights outstanding | | Share rights exercisable | | |
|-----------------|---|---|---------------------------------|---|---|
| | Number outstanding at December 31, 2011 | Weighted average remaining contractual life | Weighted average exercise price | Number exercisable at December 31, 2011 | Weighted average remaining contractual life |
| \$ | | Years | \$ | | Years |
| 2.92 | 905 | 0.25 | 2.92 | 905 | 0.25 |
| 2.70 | 643 | 0.75 | 2.70 | 643 | 0.75 |
| 2.99 | 16,454 | 1.25 | 2.99 | 16,454 | 1.25 |
| 2.81 | 12,261 | 1.75 | 2.81 | 12,261 | 1.75 |
| 2.99 | 22,685 | 2.25 | 2.99 | 22,685 | 2.25 |
| 2.75 | 34,752 | 2.75 | 2.75 | 34,752 | 2.75 |
| 2.59 | 45,856 | 3.25 | 2.59 | 27,285 | 3.25 |
| 2.70 | 73,138 | 3.75 | 2.70 | 45,224 | 3.75 |
| 3.15 | 65,792 | 4.25 | 3.15 | 18,951 | 4.25 |
| 3.08 | 73,479 | 4.75 | 3.08 | 22,988 | 4.75 |
| 3.34 | 71,377 | 5.25 | 3.34 | - | 5.25 |
| | <u>417,342</u> | | | <u>202,148</u> | |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

- 3) On 21 December 2003, the Company's Board of Directors resolved to issue up to 1,200,000 ordinary shares of NIS 1 par value, to be registered for trade in TASE and to be allotted to senior executive employees.

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

The allotted shares were held by a trustee and were granted to employees in equal batches at the end of the vesting period. The vesting period was outlined as follows: six months (1 July 2004), one year (1 January 2005), two years (1 January 2006) and three years (1 January 2007).

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

Through 31 December 2009, the employees repaid the remaining balance of the loan and all shares in trusteeship were released.

The theoretical economic value of the allotted shares – computed using the Black & Scholes shares valuation model, amounted at date of grant to U.S. \$3,024 thousand. This value is based on the following assumptions: expected dividend at a rate set to 0% in all years (as the employees are also entitled to dividend), standard deviation of expected share price returns of 33% - 39%, annual risk-free interest at a rate of 1.24%, 1.24%, 1.76% and 2.27% (in accordance with the option's expected life) and an expected average option life until exercise: six months for the first batch, one year for the second batch, two years for the third batch and three years for the fourth batch.

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

As to shares granted to manager in the Company – Note 21.a.2.

On 31 December 2009, a senior officer exercised 375,000 shares for an aggregate exercise price of \$497 thousand (NIS 1,875 thousand).

- 4) On 17 May 2004, the Company's Board of Directors approved under the 2003 plan to allot 150,000 non-marketable options (hereinafter - the options) to a senior employee, each of which is exercisable into one share of NIS1 par value.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

The said options are to be held by a trustee and they will be granted to the employee in equal batches at the end of the vesting period. The vesting periods are as follows: the first batch vests on 9 October 2004; the second on 9 October 2005; the third on 9 October 2006 and the fourth on 9 October 2007. In any case, the employee's right to exercise the options expires six years from date of grant (on 17 May 2010). The exercise price was set to NIS 10.87 (\$2.36). The market value of the Company's shares at date of allotment was NIS 20.94 (\$4.55). On 16 June 2004, the Tel-Aviv Stock Exchange approved the registration of 150,000 Company shares of NIS 1 par value, which will arise from exercise of the said options.

The theoretical economic value of the allotted shares – computed using the Black & Scholes shares valuation model, amounted at date of grant to U.S. \$346 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 33.3%, - 39.5%, annual risk-free interest at a rate of 1.74%, 1.74%, 2.82% and 3.1% (in accordance with the option's expected life) and an expected average option life until exercise: five months for the first batch, seventeen months for the second batch, twenty nine months for the third batch and forty one months for the fourth batch.

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

All options allotted in accordance with this allotment were exercised.

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

The said options are to be held by a trustee and they will be granted to the employees in equal batches at the end of the vesting period.

The vesting periods are as follows:

For three senior employees – 3 equal batches – two years, three years and four years from date of grant. For 1 senior employee – 4 equal batches – one year, two years, three years and four years from date of grant.

In any case, the employees' right to exercise the options expires six years after the date of grant. The exercise price was set to NIS 31.07 (\$6.75). The market value of the Company's shares at date of allotment was NIS 34.52 (\$7.50).

On 31 January 2006, the Tel-Aviv Stock Exchange approved the registration of 600,000 Company shares of NIS 1 par value, which will arise from exercise of the said options. 125,000 stocks out of the said amount are existing stocks held by Frutarom Ltd.

The 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.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EQUITY (continued):

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

As to the fair value of options granted to a manager – Note 21.a.2.

On September 20, 2010, the Group allotted 26,859 ordinary shares of NIS 1 par value each following the exercise of options that were granted to a senior official in the company in 2006. The exercise price for the options amounted to \$ 217 thousand.

As of December 31, 2011, the balance of warrants is 440,000 non-marketable warrants.

On September 21, 2010, the Company allotted 8,141 ordinary shares of NIS 1 par value each following the exercise of options granted to a senior office holder in the company in 2006. The exercise price in respect of the exercise of the options amounted to \$ 66 thousand.

- 6) On 15 July 2010 the Company's board of directors approved, at the recommendation of the company's payroll committee, an plan to grant options to senior managers (hereafter – the 2010 plan); as part of the plan, the Company shall grant up to 1,000,000 non-marketable warrants (hereafter – the options), each of which is exercisable into 1 ordinary share of NIS 1 par value; the options shall be granted to a manager and 10 further employees and office holders in the company; 275,000 out of the 1,000,000 options shall be granted to the manager and additional 255,000 options shall be granted in the future to employees and office holders in the Group ("options for future allocation"). The grant of options to the manager was also approved by the Company's Audit Committee. The options were granted without consideration.

The said options shall be held by a trustee and they will be granted to the employees in equal batches at the end of the vesting period. The vesting period is as follows: three equal batches – two years, three years and four years from date of grant. In any case, the option shall expire 6 years from date of grant

The exercise price was set to NIS 30.26 per share (\$ 7.84). The exercise price equals the closing price of Company share on the last trading day prior to the board's resolution to grant the options.

Each option for future allocation that will be granted to future offerees as part of the 2010 plan will be exercisable into a share for an exercise price that will equal an average of closing prices in the ten consecutive trading days prior a board 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 August 22 2010, the TASE granted its approval for listing of 1,000,000 Company shares of NIS 1 par value that will result from exercise of the said options.

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.

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

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).

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 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 \$ 30 thousands, \$26 thousand and \$27 thousand in 2011, 2010, 2009, 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 14, 2012, the Company's Board of Directors resolved to distribute a final cash dividend out of retained earnings as of December 31, 2011; the amount of this dividend is \$3,054 thousand (NIS 11,565 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 2011 and 2010 amounted to \$ 3,380 thousands (NIS 0.2 per share) and \$2,733 (NIS 0.18 per share). As mentioned in 2) above, the dividend in respect of the year ended 31 December 2011 at NIS 0.2 per share and totaling \$3,054 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, the corporate tax rates is to be gradually reduced. As a result of this amendment the corporate tax rates applicable for tax year 2009 and thereafter are as follows: 2009 - 26% and for 2010 and thereafter – 25%.

On July 14, 2009 the Economic Rationalization Law (Legislation Amendments for the Implementation of the Economic Plan for the years 2009 and 2010), 2009 (hereafter – Amendment 2009), was passed in the Knesset; this law determined, inter alia a further gradual reduction of the corporate tax rate as from 2011, as follows: 2011 – 24%, 2012 – 23%, 2013 – 22%, 2014 – 21%, 2015 – 20%, 2016 and thereafter – 18%.

The application of the law did not have a material effect on the Group's income tax expenses.

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:

Company 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%.

Company incorporated in the UK – tax rate of 26% (January – March 2011 – tax rate of 28%, April 2011 through March 2012 tax rate of 26%; commencing April 2012 – tax rate of 25%).

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

Companies incorporated in China – tax rate of 25%.

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 available to Frutarom Ltd. are:

(a) Reduced tax rates

During the 10-year period of benefits, commencing in the first year in which Frutarom Ltd. earns taxable income from the approved 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).

The period of benefits in respect of those of the abovementioned enterprises, which were activated, expires in the years 2012 through 2016.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – TAXES ON INCOME (continued):

(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.

(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.

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 | | Inventories | Other | Depreciable intangibles | In respect of Carry forward tax losses | Total |
|--|--------------------------------|-----------------------------------|--------------------------------------|----------------|--------------|----------------------------|--|---------------|
| | | Severance Pay | Vacation and recreation pay | | | | | |
| | U.S. dollars in thousands | | | | | | | |
| Balance at 1 January 2010 | 11,616 | (1,321) | (234) | (1,363) | (39) | 12,121 | - | 20,780 |
| Changes in 2010: | | | | | | | | |
| Differences from translation of foreign currency financial statements of subsidiaries | 163 | 36 | - | 127 | 22 | (543) | - | (195) |
| Amounts carried to c income | 1,147 | (122) | 69 | (299) | (318) | (557) | - | (80) |
| Balance at 31 December 2010 | <u>12,926</u> | <u>(1,407)</u> | <u>(165)</u> | <u>(1,535)</u> | <u>(335)</u> | <u>11,021</u> | <u>-</u> | <u>20,505</u> |
| 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 | <u>12,961</u> | <u>(1,055)</u> | <u>(175)</u> | <u>(929)</u> | <u>(126)</u> | <u>12,347</u> | <u>(427)</u> | <u>22,596</u> |

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 | |
|-------------------------------|----------------------------------|-----------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Among non-current assets | 2,073 | 1,362 |
| Among non-current liabilities | (24,669) | (21,867) |
| | <u>(22,596)</u> | <u>(20,505)</u> |

- 3) The deferred taxes in respect of Group activities in Israel are computed at the tax rate of 13% (2010 – 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:

| | 2011 | 2010 | 2009 |
|--|----------------------------------|---------------|--------------|
| | U.S. dollars in thousands | | |
| Current taxes: | | | |
| For the reported year's income | 11,592 | 15,178 | 10,112 |
| Adjustments in respect of previous years | (1,114) | 577 | (864) |
| | <u>10,478</u> | <u>15,755</u> | <u>9,248</u> |
| Deferred taxes: | | | |
| Creation and reversal of deferred taxes | 357 | (80) | 473 |
| T o t a l | <u>10,835</u> | <u>15,675</u> | <u>9,721</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:

| | 2011 | 2010 | 2009 |
|--|----------------------------------|-------------|-------------|
| | U.S. dollars in thousands | | |
| Income before taxes on income, as reported in the income statements | 52,866 | 59,786 | 42,941 |
| Theoretical tax expense in respect of this income – at 24% (2010 – 25%; 2009 – 26%) | 12,688 | 14,947 | 11,165 |
| Less – tax benefit arising from approved enterprise /benefited enterprise status | (1,788) | (806) | (810) |
| Increase in taxes resulting from different tax rates applicable to foreign subsidiaries | 1,167 | 2,922 | 693 |
| Decrease in taxes arising from computation of deferred taxes at a rate which is different from the theoretical rate | 331 | (764) | (212) |
| 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 | (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) | (151) | (502) | (327) |
| 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 | 832 |
| Income taxes in different tax rates | | - | (377) |
| Other | (52) | (176) | (379) |
| Taxes on income for the reported year | 11,949 | 15,098 | 10,585 |

f. Tax Assessments

The Company and its Israeli subsidiaries have received final tax assessments through the year 2006.

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 October 31, 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 commencing 2011. Also, 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. Due to the delayed publication of the law memorandum, company's/group management expects that the Tax Authority will extend the term of the Temporary Order so that it will apply to the years 2010 and 2011 to the effect that the new law memorandum will only be applicable commencing 2012.

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 borrowings and long-term loans 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. and by the First International Bank of Israel Ltd., 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 \$180 million at any given time.
 - 2) The amount representing the Group's equity would not be lower than 30% of total assets.
 - 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 6.
- d. As of 31 December 2011, the Group meets all the obligations presented above.

NOTE 15 – ACCOUNTS RECEIVABLE:

| | December 31 | |
|---|----------------------------------|-------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| a. Trade – composed as follows: | | |
| Open accounts | 84,217 | 67,810 |
| Interested parties | 139 | 275 |
| | 84,356 | 68,085 |
| Cheques collectible | 1,698 | 1,735 |
| | 86,054 | 69,820 |
| The item includes – provision for doubtful accounts | 2,808 | 2,255 |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 15 – ACCOUNTS RECEIVABLE (continued):

As of December 31, 2011 certain trade receivable balances– amounting to \$ 17,514 thousands (2010 - \$ 15,182 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 \$1,167 thousand (2010 - \$ 311 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 | |
|---------------------------------|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Through 60 days | 16,254 | 14,309 |
| 60 to 120 days | 1,260 | 873 |
| | <u>17,514</u> | <u>15,182</u> |
| Provision for doubtful accounts | (1,167) | (311) |
| | <u>16,347</u> | <u>14,871</u> |

As of December 31, 2010, the company made a provision for doubtful accounts in respect of balances in the total amount of \$2,582 thousand (2010 – \$2,719 thousand) in arrears of more than 120 days. The amount of the provision as of December 31, 2010 was \$1,641 thousand (2010 – \$1,944 thousand).

The aging of the said balances is presented below:

| | December 31 | |
|---|----------------------------------|--------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| 120 days to 1 year | 1,639 | 1,494 |
| Over 1 year | 943 | 1,225 |
| | <u>2,582</u> | <u>2,719</u> |
| Provision for impairment of receivables | (1,641) | (1,944) |
| | <u>941</u> | <u>775</u> |

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 21b).

| b. Other: | December 31 | |
|--|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Employees and institutions | 272 | 309 |
| Government institutions | 5,872 | 5,506 |
| Refund receivable in respect of acquisition of FSI | - | 3,850 |
| Sundry | 846 | 1,171 |
| | <u>6,990</u> | <u>10,836</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 16 – INVENTORIES

| | December 31 | |
|---|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| Raw materials and supplies | 52,537 | 43,630 |
| Products in process | 6,976 | 4,678 |
| Finished products | 50,144 | 36,408 |
| | <u>109,657</u> | <u>84,716</u> |
| Inventories for commercial operations – purchased products | 1,557 | 1,769 |
| | <u>111,214</u> | <u>86,485</u> |

NOTE 17 – PRE-PAID EXPENES IN RESPECT OF OPERATING LEASE

Frutarom Ltd is engaged in operating lease agreements in relation to vehicles it is using. For the last three months of the agreement, the Company paid a total of \$167 thousand (as of December 31, 2010 - \$ 163 thousands).

NOTE 18 – CASH AND CASHEQUIVALENTS:

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

| | Weighted Interest rates as of 31 December 2011 | December 31 | |
|--------------------|---|----------------------------------|---------------|
| | | 2011 | 2010 |
| | | U.S. dollars in thousands | |
| In Dollars | 0.37% | 12,804 | 15,296 |
| In Pounds sterling | 0. 0% | 4,896 | 5,687 |
| In Euro | 0.42% | 10,649 | 13,147 |
| In Swiss Francs | 0.12% | 772 | 5,823 |
| Yuan | 2.5-5% | 4,949 | 2,157 |
| Other | | 2,402 | 2,279 |
| | | <u>36,472</u> | <u>44,389</u> |

NOTE 19 – ACCOUNTS PAYABLE:

| | December 31 | |
|--|----------------------------------|---------------|
| | 2011 | 2010 |
| | U.S. dollars in thousands | |
| a. Trade: | | |
| Open accounts | 40,239 | 30,380 |
| b. Other: | | |
| Payroll and related expenses | 10,759 | 8,820 |
| Government institutions | 7,418 | 12,031 |
| Provision for commissions and discounts | 2,282 | 1,330 |
| Liability to Bank of New York (Note 11b1) | - | 116 |
| Accrued expenses | 7,341 | 8,326 |
| Provisions | 236 | 207 |
| Conditional consideration in respect of acquisition of Flavor Systems | 9,793 | - |
| Sundry | 615 | 608 |
| | <u>38,444</u> | <u>31,438</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 19 – ACCOUNTS PAYABLE (continued):

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 | | |
|--|----------------------------------|----------------|----------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| a. Cost of Sales: | | | |
| Industrial operations: | | | |
| Materials consumed | 256,031 | 200,141 | 184,054 |
| Payroll and related expenses | 44,408 | 38,400 | 38,748 |
| Depreciation and amortization | 11,209 | 9,926 | 10,686 |
| Other production expenses | 29,206 | 25,758 | 23,818 |
| | <u>340,854</u> | <u>274,225</u> | <u>257,306</u> |
| Decrease (increase) in work in process and finished products inventories | (16,034) | (2,372) | 6,665 |
| | <u>324,820</u> | <u>271,853</u> | <u>263,971</u> |
| Commercial operations – cost of products sold | 5,046 | 4,389 | 5,706 |
| | <u>329,866</u> | <u>276,242</u> | <u>269,677</u> |
| b. Selling, Marketing, Research and Development Expenses – net: | | | |
| Payroll and related expenses | 48,136 | 41,386 | 41,312 |
| Transportation and shipping | 14,335 | 12,164 | 11,126 |
| Provisions for payment of commissions and royalties | 3,742 | 3,109 | 2,961 |
| Provision for doubtful accounts | (347) | 214 | 605 |
| Depreciation and amortization | 5,984 | 5,253 | 4,856 |
| Travel and entertainment | 3,416 | 2,733 | 2,638 |
| Office rent and maintenance | 3,902 | 3,841 | 4,032 |
| Other | 9,473 | 8,361 | 7,878 |
| | <u>88,641</u> | <u>77,061</u> | <u>75,408</u> |
| The item includes expenses for product development and research activities, net* | <u>24,333</u> | <u>21,563</u> | <u>20,976</u> |
| * net of participation from government departments and others | <u>655</u> | <u>992</u> | <u>540</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 20 – INCOME STATEMENT ANALYSIS (continued):

| | Year ended 31 December | | |
|--|----------------------------------|---------------|---------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| c. General and Administrative Expenses: | | | |
| Payroll and related expenses | 23,864 | 20,720 | 18,960 |
| Depreciation and amortization | 3,419 | 2,902 | 2,682 |
| Professional fees | 2,110 | 2,067 | 2,564 |
| Communication, office supplies and Maintenance | 4,416 | 5,031 | 4,735 |
| Travel and entertainment | 1,686 | 1,396 | 1,014 |
| Other | 3,736 | 2,983 | 3,049 |
| | <u>39,231</u> | <u>35,099</u> | <u>33,004</u> |
| d. Other Expenses (income) – net: | | | |
| Capital loss on sale of fixed assets | 17 | (508) | (293) |
| Rental | (36) | (69) | (85) |
| Payment of compensation to distributor in respect of termination of agreement | | - | 254 |
| Expenses in respect of acquisition of subsidiaries | 1,876 | 85 | - |
| Expenses for institutional audit | 150 | 223 | - |
| Other | 34 | (49) | (71) |
| | <u>2,041</u> | <u>(318)</u> | <u>(195)</u> |
| e. Financial Expenses – net: | | | |
| In respect of long-term loans and credit | 1,489 | 1,749 | 3,806 |
| In respect of exchange differences of trade receivables and trade payable balances – net | 3,254 | 1,107 | 506 |
| In respect of cash and cash equivalents, short-term deposits and loans, short- term credit and other – net | 1,055 | 340 | 32 |
| | <u>5,798</u> | <u>3,196</u> | <u>4,344</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 36.93% 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.

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>2011</u> | <u>2010</u> | <u>2009</u> |
|---|----------------------------------|----------------|----------------|
| | <u>U.S. dollars in thousands</u> | | |
| Income (expenses): | | | |
| Sales – affiliates (companies controlled by the controlling shareholder): | | | |
| Fallek Chemical Japan | 405 | 593 | 621 |
| Other | 9 | 9 | 7 |
| | <u>414</u> | <u>602</u> | <u>628</u> |
| Purchases: | | | |
| Affiliates (companies controlled by the controlling shareholder): | | | |
| Azur S.A. | (1,819) | (1,689) | (291) |
| Controlling shareholders | - | - | - |
| | <u>(1,819)</u> | <u>(1,689)</u> | <u>(291)</u> |
| Dividend | <u>(1,257)</u> | <u>(1,019)</u> | <u>(926)</u> |
| Other expenses: | | | |
| Affiliates - | | | |
| Azur S.A. | (35) | - | (96) |
| Benefits to related parties: | | | |
| Wages and salaries | <u>(2,119)</u> | <u>(2,040)</u> | <u>(1,835)</u> |
| Director fees (in the Company) | <u>(192)</u> | <u>(150)</u> | <u>(148)</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

2) Shares granted to a manager in the Company

The total benefit component granted to a manager under the 2003 and 2010 plans (see note 12) in the years 2009 through 2011 as computed at date of grant is \$156 thousand, \$516 thousand and \$97 thousand, respectively.

Benefit costs that have been charged to the income statements, in respect of the said shares granted in the years 2011, 2010 and 2009 are \$216 thousand, \$223 thousand and \$138 thousand, respectively.

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

On July 15, 2010, the Company's board of directors approved the grant of 275,000 options to a manager in 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.

- 3) 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 | | |
|---|----------------------------------|-------------|-------------|
| | 2011 | 2010 | 2009 |
| | U.S. dollars in thousands | | |
| 1) Current receivables – presented among “other receivables-other” and “trade receivables” | | | |
| Affiliated companies: | | | |
| Fallek | 137 | 275 | 136 |
| Azur S.A. | - | - | 139 |
| ICC | 2 | - | - |
| | <u>139</u> | <u>275</u> | <u>275</u> |
| Highest balance during the year | <u>221</u> | <u>293</u> | <u>340</u> |
| 2) Current payables shareholder and related parties: | | | |
| Azur S.A. | 57 | 29 | - |
| | <u>57</u> | <u>29</u> | <u>-</u> |

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 22 – SUBSEQUENT EVENTS:

a. Distribution of dividend

On March 14, 2012 the Group's Board of Directors declared the distribution of a dividend of NIS 0.2 per share. Total amount of the dividend is \$3,054 thousand (based on exchange rate as of date of confirmation of these financial statements).

b. 2012 Option plan

On January 30, 2012, the Company's board of directors adopted the 2012 option plan – for compensation of employees, office holders and service providers in the Company and/or related companies thereof. As was the case in the 2003 plan used by the Company through 2011, for the purpose of the 2012 plan the Company acquires its own shares in the Tel Aviv Stock Exchange in accordance with the resolution of the Company's board of directors. The options which are granted under the 2012 plan are allocated against Company shares held by the Company until the options in respect of which the shares were purchased are exercised. The exercise price in respect of the options granted under the 2012 plan is one third of the average price per shares paid for the shares purchased by the Company for the purpose of the 2012 plan. Options granted under the 2012 plan are exercisable in 3 equal batches at the end of each year over the three years from date of grant.

Except in the case of several exceptional cases, where employer-employee relationship terminates, the employee will be entitled to exercise all the exercisable options at the date of termination of employer-employee relationship, within 90 days from that date. The remaining balance of options granted to this employee and which have not been exercised by this employee within that period expire. Options that are not exercisable at the date of termination of employer-employee relationship shall expire immediately upon termination.

c. Extension of period for exercise of options

On January 30, 2012, the board of directors resolved to extend by 12 months the exercise period of 350,000 warrants allotted in January 2006 to the Company's President and CEO and of 53,365 warrants allotted in January 2006 to the Company's Vice President and CFO; this resolution was made after the audit committee has approved the extension of the exercise period. According to the said resolution, the last exercise date of these warrants shall be January 31, 2013 instead of January 31 2012 (the original expiry date).

d. 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 \$ 5.9 million (£ 3.8 million) and an additional consideration to be computed in accordance with performances based on a mechanism set in the agreement; in the opinion of the Company, the additional consideration shall not exceed 5% of the amount of the transaction.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 22 – SUBSEQUENT EVENTS (continued):

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. It 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 \$7.1 million.

Savoury Flavours' production site is located close to EAFI's production site, which manufactures savory products as well. The geographic proximity, along with the two companies' complementary product portfolios and technologies, will allow significant business synergies between Savoury Flavours' and Frutarom's fast growing activities in savory foods categories worldwide.

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

e. Acquisition of Etol

In January-February 2012, Frutarom purchased, through a Swiss subsidiary, app. 63.4% of the share capital of the Slovenian public company Etol. The acquisition was made by way of transactions outside and inside the Stock Exchange for a total amount of € 22,269 thousands. On February 11, 2012, Frutarom published a bid in Slovenia for the purchase of the 93,109 remaining shares (constituting 36.6% of the share capital of Etol) in consideration for 141 € per share (a total of € 13,128 thousands). At the date of filing these financial statements, the bid had not yet been completed.

The acquisition was financed in full by a short-term bank credit, which would be replaced during 2012 by a long-term credit.

Etol, founded in 1924, develops, manufactures and markets flavor solutions, focusing on natural flavor products for the food and beverage industry. Etol has great experience in developing and producing flavors and products based on local fruits, and plant bases for beverages. Frutarom plans to heavily invest in and greatly expand these activities.

Etol and its subsidiaries employ some 240 employees including a leading human capital in the areas of research and development and sales, and an experienced and successful management team. Etol has a manufacturing and marketing site in Sofia Vas, Slovenia, in which it has invested extensively over the past few years, and has incorporated innovative technologies. Etol also has additional real estate properties for future expansion. Etol's products are sold to a wide customer base in Central and Eastern Europe and in emerging markets, including Russia, Poland, the Ukraine, Turkey, Croatia, Serbia, Belarus, Hungary, Macedonia, the Czech Republic, Kazakhstan and in other developed countries such as Switzerland, Germany and the UK. Leading food and beverage manufacturers in the countries it operates are among Etol's customers, including large multi-national food companies. Etol's operations are synergetic with Frutarom's activities.

In the twelve months ended September 30, 2011, Etol's sales turnover amounted to € 48.5 million (\$ 67.8 million).

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 22 – SUBSEQUENT EVENTS (continued):

f. 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 in consideration for \$ 15.7 million (27.1 Brazilian reais).

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 bank credit and was completed on the date of signing the agreement.

g. Updating financial criteria

1. On February 16, the following financial criteria were updated:

- i. The group's equity shall not be lower than \$ 300 million at any point of time.
- ii. The group's equity shall not constitute less than 35% of total assets
- iii. The following ration – group's financial liabilities divided by its operating income from operating activities before tax and with the addition of depreciation and amortization – shall not exceed 4.25.

2. The Company's assets are subject to a negative pledge.

3. The Company's has undertaken to restrict dividend distributions as follows:

- i. The Company will be allowed to distribute up to 50% of retained earnings accumulated through December 31, 2011 (based on the retained earnings item in the Company's balance sheet as of December 31, 2011).
- ii. The Company will be allowed to distribute up to 50% of its annual profit per each calendar year, based on the annual profit item presented in the annual financial statements of the Company for the calendar year in which the said profit was accrued.

FRUTAROM INDUSTRIES LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 23 – LIST OF CONSOLIDATED SUBSIDIARIES AND INVESMENT IN SUBSIDIARIES

a) LIST OF CONSOLIDATED SUBSIDIARIES

| Name of company | Country | Percentage of shareholding and control | |
|--|--------------|--|------|
| | | 31 December | |
| | | 2011 | 2010 |
| | | % | % |
| Subsidiaries: | | | |
| Frutarom Ltd.(1) | Israel | 100 | 100 |
| Frutarom Trust Ltd.(2) | Israel | 100 | 100 |
| (1)Frutarom Ltd. holds the following companies: | | | |
| Frutarom Trade and Marketing (1990) Ltd. | Israel | 100 | 100 |
| Galilee Essences Ltd.(3) | Israel | 100 | 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. | 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.(6) | Hong Kong | 100 | 100 |
| (2)Frutarom Trust Ltd. holds Company shares in trust for company's employees | | | |
| (3)Inactive company | | | |
| (4) Frutarom (UK) Holdings Ltd. holds full ownership in the following companies: | | | |
| Frutarom Switzerland Ltd.(7) | | 100 | 100 |
| Frutarom (UK) Ltd.(8) | | 100 | 100 |
| Frutarom Italy S.R.L. (9) | | 100 | - |
| Frutarom Norway A.S. | | 100 | 100 |
| (5) International Frutarom Corporation holds the following companies: | | | |
| Frutarom U.S.A. Inc.(10) | | 100 | 100 |
| Frutarom Flavors & Fragrance Costa Rica SRL | | 100 | - |
| (6) Frutarom (Asia Pacific) Ltd. holds in the following companies: | | | |
| Frutarom Flavors & Ingredients (Shanghai)(*) | | 99 | - |
| (7) Frutarom Switzerland Ltd. has full ownership in the following companies: | | | |
| Frutarom Germany GmbH(11) | | 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.(12) | | 100 | 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 | |
| | | 2011 | 2010 |
| | | % | % |
| (8) Frutarom (UK) Ltd. has full ownership in the following companies: Aromco South Africa (PTY) Ltd. MIS Aromco Flavors India (P)Ltd. | | 100 100 | - - |
| (9) Frutarom Italy S.R.L. has holdings in the following companies: Frutarom Czech Republic S.r.o. (**) | | 90 | - |
| (10) Frutarom U.S.A. Inc. has full ownership in the following companies: Frutarom USA Holdings Inc. Frutarom USA Inc. Flavors system International Inc.(13) | | 100 100 100 | 100 100 - |
| (11)Frutarom Germany GmbH has holdings in the following companies: Frutarom Savory Solutions GmbH (14) | | 100 | 100 |
| (12)Frutarom Netherlands B.V. holds full ownership in the following companies: Frutarom Belgium N.V. | | 100 | 100 |
| (13) Flavors system International Inc. holds full ownership in the following companies: FSI Beverage System, LLC FSI Fragrance, LLC | | 100 100 | - - |
| (14)Frutarom Savory Solutions GmbH has full ownership in the following companies: GewürzMüller AG (3) NESSEpol Sp. z.o.o | | 100 100 | 100 100 |

(*) 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

| Name of the subsidiary | State of Incorporation | Percentage of shareholding | The value of the investment | Capital notes |
|---------------------------|------------------------|----------------------------|-----------------------------|---------------|
| | | | 31 December | |
| U.S. dollars in thousands | | | | |
| Frutarom Ltd. | Israel | 100% | 292,348 | 102,653 |
| Frutarom Trust Ltd. | Israel | 100% | - | - |