

AMERICAN ISRAELI PAPER MILLS LTD  
Form 20-F  
June 29, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

*For the fiscal year ended December 31, 2006*

Commission File Number 1-04212

**AMERICAN ISRAELI PAPER MILLS LTD.**

(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

**Israel**

(Jurisdiction of incorporation or organization)

**P.O. Box 142, Hadera 38101, Israel**

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
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<b>Ordinary Shares par value NIS .01 per share</b>	<b>American Stock Exchange</b>
Securities registered or to be registered pursuant to Section 12(g) of the Act:	

**None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

**4,032,723 Ordinary Shares, par value NIS 0.01 per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes** **No**

If this report is an annual or transition report, indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 **Yes** **No**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: **Yes** **No**

4,032,723 Ordinary Shares, par value NIS 0.01 per share

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow: **Item 17** **Item 18**

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **Yes**

**No**

**PART I**

**ITEM 1 - IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable to Annual Reports

**ITEM 2 - OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable to Annual Reports

**ITEM 3 - KEY INFORMATION**

**A. Selected Financial Data**

American Israeli Paper Mills Ltd. ( "AIPM" or the "Company" ) prepares its financial statements in accordance with Israeli GAAP. Israeli GAAP and U.S. GAAP vary in certain respects, as it relates to the Company, as described in Item 17.

The following selected financial data is derived from the audited consolidated financial statements of the Company.

The financial data is presented in New Israeli Shekel (NIS) as follows: AIPM made a transition to reporting in nominal New Israeli Shekels (NIS) in 2004, pursuant to the directives of Standard 12 of the Financial Accounting Standards Board in Israel. Prior to 2004 AIPM's reports were in NIS, adjusted to changes in the exchange rate of the U.S. dollar against the NIS.

The comparison figures for the years 2002 - 2003 are the dollar figures, as reported in the past, multiplied by the exchange rate of the U.S. dollar as at December 31, 2003, the day of the transition to NIS-based reporting pursuant to Standard 12 (\$1 = NIS 4.379). See also note 1b to the Financial Statements.

## Five Fiscal Year Financial Summary

## According to Israeli GAAP

(In Thousands of NIS Except Per Share Amounts)

Year Ended December 31

Income Statement data:	2006	2005	2004	2003	2002
Sales	530,109	482,461	482,854	465,092	455,775
Income from ordinary operations	50,501	*43,338	*54,438	46,584	36,455
Share in profits (losses) of associated companies, net	****(26,202)	16,414	25,072	35,549	16,727
Net income	<sup>1</sup> 13,330	<sup>1</sup> 45,715	<sup>1</sup> 62,732	<sup>1</sup> 60,047	37,460
<b>Selected balance sheet data:</b>					
Total assets	1,173,287	1,155,758	1,162,387	1,253,274	1,052,123
Fixed assets	400,823	379,934	345,239	340,543	339,579
Long-term debt	256,290	260,581	261,269	268,052	70,257
Shareholders' equity	430,842	523,384	575,313	614,230	650,950
<b>Per Share Data:</b>					
Shares outstanding at end of year	4,032,723	4,002,205	3,996,674	3,968,295	3,918,710
Amount in NIS	40,327	40,022	39,967	39,683	39,187
Net income per NIS 1 par value:					
Primary	3.31	***11.43	***15.77	***15.26	***9.56
Fully diluted	3.28	***11.35	***15.44	***14.99	***9.49
Dividend declared per share	<sup>2</sup> 24.85	<sup>2</sup> *24.99	<sup>2</sup> 25.12	<sup>2</sup> 25.12	<sup>2</sup> 5.30

\* Reclassified

\*\* Consists of two dividends that were declared in 2005 (see comment 2 below).

\*\*\* As a result of implementing retroactively the change of accounting policy.

\*\*\*\* Amount does not include the cumulative affect of a change in accounting policy of associated company of NIS (461).

(1) The net income includes gains in the years 2005, 2004 and 2003 (in the sum of 8,000 thousands, NIS 14,440 thousands and NIS 2,700 thousands respectively, which relate to certain tax benefits for a further discussion of these items, see Item 5 Operating Financial Review and Prospects.

(2) Dividend for 2002, in the sum of NIS 6.31 per share (\$1.44 per share) was declared in March 2003 and paid in April 2003.

Dividend paid in 2003 includes a special dividend for 2003 in the sum of NIS 18.81 per share (\$4.29 per share).

Dividend for 2003 in the sum of NIS 25.12 per share (\$5.54 per share) was declared in August 2004 and paid in September 2004.

Dividend for 2005 in the sum of NIS 12.50 per share (\$2.71 per share) was declared in August 2005 and paid in September 2005. Additional dividend for 2005 in the sum of NIS 12.49 per share (\$2.71 per share) was declared in December 2005 and paid in January 2006.

Dividend for 2006 in the sum of NIS 24.85 per share (\$ 5.64 per share) was declared in June 2006 and paid in July 2006.



**According to U.S. GAAP****(In Thousands of re-measured NIS except per share amounts)**

<b>Income statement and balance sheet data:</b>	<b>Year Ended December 31</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Sales	530,109	482,461	482,854	481,491	492,990
Income from ordinary operations	76,917	63,258	63,974	53,688	53,751
Share in profits (losses) of associated companies, net	(19,686)	8,193	29,213	20,972	27,464
Net income	<sup>1</sup> 23,909	<sup>1</sup> 41,861	<sup>(1)</sup> 58,720	<sup>1</sup> 38,469	54,624
Total assets	1,123,964	1,097,543	1,107,725	1,189,215	1,026,083
Fixed assets	362,539	340,914	300,746	291,060	282,281
Long-term debt	257,075	260,581	261,269	268,052	76,001
Shareholders' equity	374,768	461,406	520,482	550,354	602,675
<b>Per Share Data:</b>					
Shares outstanding at end of year	4,032,723	4,002,205	3,996,674	3,968,295	3,918,710
Share outstanding to compute:					
Basic net income per share	4,025,181	3,999,910	3,978,339	3,938,035	3,918,710
Diluted net income per share	4,055,628	4,051,610	4,043,714	3,969,708	3,933,280
Amount in NIS	40,327	40,022	39,967	39,683	39,187
Net income per share (re-measured NIS)					
Basic	5.94	10.47	14.76	9.77	13.94
Diluted	5.89	10.33	14.52	9.69	13.81
Dividend declared per share	<sup>2</sup> 24.85	<sup>2**</sup> 24.99	<sup>2</sup> 25.12	<sup>2</sup> 25.55	<sup>(2)</sup> 5.77

For further information about the effect of application of U.S. GAAP, see Item 17.

\*\* Consist of two dividends were declared in 2005 (see comment 2 below)

(1) The net income includes losses in the years 2005 and 2003, in the sum of NIS 10,000 thousands and NIS 16,986 thousands respectively, [representing other than temporary impairment of investment in associated companies (see Item 17-e)]. Net income in the years 2005, 2004 and 2003, includes gains of NIS 8,000 thousands, NIS 14,440 thousands and NIS 2,700 thousands respectively, originated from certain tax benefits. For a further discussion of these items, see discussion in Item 5 – Operating Financial Review and Prospects.

(2) Dividend for 2002, in the sum of NIS 6.61 per share (\$1.44 per share) was declared in March 2003 and paid in April 2003.

Dividend paid in 2003 includes a special dividend for 2003 in the sum of NIS 19.04 per share (\$4.29 per share).

Dividend for 2003 in the sum of NIS 25.12 per share (\$5.54 per share) was declared in August 2004 and paid in September 2004.

Dividend for 2005 in the sum of NIS 12.50 per share (\$2.71 per share) was declared in August 2005 and paid in September 2005.

Additional dividend for 2005 in the sum of NIS 12.49 per share (\$2.71 per share) was declared in December 2005 and paid in January 2006.

Dividend for 2006 in the sum of NIS 24.85 per share (\$ 5.64 per share) was declared in June 2006 and paid in July 2006.

**Exchange Rates**

The exchange rate between the NIS and U.S. dollar published by the Bank of Israel was NIS 4.033 to the dollar on May 31, 2007. The high and low exchange rates between the NIS and the U.S. dollar during the six months of December 2006 through May 2007, as published by the Bank of Israel, were as follows:

<u>Month</u>	<u>High</u>	<u>Low</u>
	1 U.S. dollar =	1 U.S. dollar =
December 2006	4.234 NIS	4.176 NIS
January 2007	4.260 NIS	4.187 NIS
February 2007	4.254 NIS	4.183 NIS
March 2007	4.222 NIS	4.155 NIS
April 2007	4.135 NIS	4.014 NIS
May 2007	4.065 NIS	3.932 NIS

The average exchange rate between the NIS and U.S. dollar, using the average of the exchange rates on the last day of each month during the period, for each of the five most recent fiscal years was as follows:

<u>Period</u>	<u>Exchange Rate</u>
January 1, 2001 - December 31, 2001	4.219 NIS/\$1
January 1, 2002 - December 31, 2002	4.736 NIS/\$1
January 1, 2003 - December 31, 2003	4.512 NIS/\$1
January 1, 2004 - December 31, 2004	4.483 NIS/\$1
January 1, 2005 - December 31, 2005	4.878 NIS/\$1
January 1, 2006 - December 31, 2006	4.456 NIS/\$1

**Forward Looking Statements**

This Annual Report on Form 20-F contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the 1934 Act ) (collectively, the Safe Harbor Provisions ). These are statements that are not historical facts and include statements about our beliefs and expectations. These statements contain potential risks and uncertainties and actual results may differ significantly. Forward-looking statements are typically identified by the words believe , expect , intend , estimate and similar expressions. Such statements appear in this Annual Report and include statements regarding the intent, belief or current expectation of the Company or its directors or officers. Actual results may differ materially from those projected, expressed or implied in the forward-looking statements as a result of various factors including, without limitation, the factors set forth below under the caption Risk Factors (the Company refers to these factors as Cautionary Statements ). Any forward-looking statements contained in this Annual Report speak only as of the date hereof, and the Company cautions potential investors not to place undue reliance on such statements. The Company undertakes no obligation to update or revise any forward-looking statements. All subsequent written or oral forward-looking statements attributable to the Company or persons acting on the Company s behalf are expressly qualified in their entirety by the Cautionary Statements.

**B. Capitalization and indebtedness**

Not applicable.

**C. Reason for the offer and use of proceeds**

Not applicable.

**D. Risk factors**

**Macro-economic risk factors**

**A slowdown in the market may result in a reduction of profitability**

A slowdown in the global markets as well as in the Israeli market may cause: a decrease in the demand for the Company's and its associated companies' products, an increase in the competition with imported products and a decrease in the profitability of export and that could result in a reduction in the Group's sales and a decline in its profitability.

**Future legal restriction may negatively affect the results of operations**

The Company's activities and its subsidiaries and associated companies' activities are confined by legal constraints (such as government policy on various subjects, different requirements made by the authorities supervising environmental regulations and governmental decisions to raise minimum wages). These restrictions may affect the results of operations of the Group.

**Any future rise in the inflation rate may negatively affect business**

Since the Company possesses a significant amount of CPI-linked liabilities, a high inflation rate may cause significant financial expenses. Consequently, the Company occasionally enters into hedging transactions to cover the exposure due to the liabilities. A high inflation rate may also affect payroll expenses, which, at the long run, tends to be adjusted to the changes in the CPI.

**Exposure to Exchange Rate Fluctuation**

The Company, its consolidated subsidiaries and associated companies are exposed to risks due to changes in the foreign exchange rates, either due to importing raw materials and finished products or due to exporting to international markets. Changes in the foreign exchange rates of the different currencies compared to the New Israeli Shekel may cause erosion in profitability and cash flow.

**Risk Factors relating to the Company**

**The Company faces significant competition in the markets the Company operates in**

The Company operates in the packaging paper and office supplies industries, both of which are highly competitive. In the packaging paper industry the Company faces competition from imported paper. In the office equipment sector the Company faces competition from many



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suppliers that operate in the Company's markets. The associated companies are also exposed to competition in all of their operations. This competition may negatively affect the future results. For further information see the section titled "Competition" in Item 4B below.

The Company is exposed to increases in the cost of raw materials.

The increase in the activity of the paper machines, which are based on paper waste as a recycled fiber, makes it necessary to increase the collection of paper waste and seek wider range of collection sources. The lack of enforcement of the Israeli recycling laws, which require waste recycling, makes it difficult to find alternative resources at a competitive cost, but the enactment of the Clean Environment Act in January 2007, which charges a landfill levy on waste may, if effectively enforced, significantly improve the ability to collect paper waste.

There is an exposure in the associated companies resulting from fluctuation of prices of raw material and of the imported products, which arrive to Israel without tariffs or entrance barriers. Exceptional price increase of raw materials and imported products may have an adversary effect on these Companies' profitability.

The Company is dependent on energy prices.

AIPM's activities are highly dependent on the consumption of energy and therefore are influenced by fuel and electricity prices. AIPM's profitability may suffer if there is an exceptional increase in energy prices.

Account Receivable Risks

Most of the Company's and its subsidiaries' sales are made in Israel to a large number of customers. Part of the sales is made without full security of payment. The exposure to credit risks relating to trade receivables is usually limited, due to the relatively large number of our customers. The Company performs ongoing credit evaluations of its customers to determine the required amount of allowance for doubtful accounts. An appropriate allowance for doubtful accounts is included in the financial statements.

The operations in Turkey may suffer as a result of the Turkish economy.

The Company is exposed to various risks related to its activities in Turkey, where Hogla-Kimberly Ltd ( H-K ) operates through its subsidiary, Kimberly Clark Turkey ( KCTR ). These risks result from economic instability and high inflation rates and exchange rate fluctuations, which have characterized the Turkish economy during the past years, and may be repeated and adversely affect KCTR's activities.

Risks Associated with credit from banks

The Company forms part of the I.D.B. Group and is influenced by the Israel Banking Supervisor's Correct Banking Management Regulations, which includes amongst other things, limits to the volume of loans an Israeli bank can issue to a single borrower; a single borrowing group (as this term is defined in the said regulations), and to the six largest borrowers and borrowing groups at a bank corporation. I.D.B. Development, its controlling shareholders and some of the companies held thereby, are considered to be a single borrowing group. Under certain circumstances, this can influence the AIPM Group's ability to borrow additional sums from Israeli banks and to carry out certain business transactions in partnership with entities that drew on the aforesaid credit.

For further information, see Item 11 Quantitative and Qualitative Disclosure about Market Risk.

## ITEM 4 - INFORMATION ON THE COMPANY

### A. History and Development of the Company

American Israeli Paper Mills Ltd. was incorporated in 1951 under the laws of the State of Israel, and, together with its subsidiaries and associated companies (which together with the Company are referred to as the Group) is Israel's largest manufacturer of paper and paper products.

The Company's principal executive offices, and also the Company's registered offices, are located at 1 Meizer St., Industrial Zone, P.O. Box 142, Hadera, Israel, Tel: (972-4) 634-9349, fax: (972-4) 633-9740.

The organizational structure of the Company and certain subsidiaries was changed as of January 1, 1999. This change was intended to result in an operational separation between various activities, especially in the paper and board divisions, to allow for better business focus, greater operating efficiency and the formulation of business strategies that facilitate the establishment of additional international strategic alliances.

Within the framework of the organizational changes, different fields of operations were defined and separated, including printing and writing paper and packaging paper. For each of them a separate management team was assigned.

Over the last few years, the Group has participated in several joint ventures as follows:

1. In July 1992, the Group purchased 25% of the shares of Carmel Container Systems Ltd. (Carmel), a leading Israeli designer, manufacturer and marketer of containers, packaging materials and related products. As of December 31, 2006, the Group held 26.25% of the shares of Carmel shares. As a result of a self acquisition by Carmel, the Group's holding in Carmel increased as of June 01, 2007, to 36.2% of the shares of Carmel shares. Another major shareholder in this company is Kraft Group LLC (an American shareholder) (49.6%). Carmel shares were traded on the AMEX and were deregistrated and delisted in 2005.
2. In 1996, Kimberly Clark Ltd. (KC) acquired 49.9% of the shares of Hogla, a wholly-owned subsidiary of the Company and a leading Israeli consumer products company, which was then renamed Hogla-Kimberly Ltd (H-K). H-K is engaged in the production and marketing of household paper products, hygiene products, disposable diapers and complementary kitchen products. The partnership was intended to expand the local production base in Israel, in order to serve both local and regional demand, and to offer H-K access to international markets. In 1999, H-K purchased Ovisan, which was renamed to Kimberly Clark Turkey (KCTR), a Turkish manufacturer and marketer of diapers and paper products. On March 31, 2000, KC increased its holdings in H-K to 50.1%.
3. Effective January 1, 2000, AIPM entered into a joint venture agreement with Neusiedler AG (NAG), pursuant to which NAG acquired 50.1% of AIPM's printing and writing paper operations. The printing and writing paper operation was separated from AIPM upon the completion of this transaction and was sold to Neusiedler Hadera Paper (NHP), a subsidiary that was established for this purpose, of which NAG acquired 50.1%. NHP was renamed in 2004 and is now called Mondi Business Hadera Paper (Mondi Hadera).
4. Amnir Recycling Industries Ltd. (Amnir) (a wholly owned subsidiary of AIPM), which is engaged in the collection and recycling of paper and plastic waste and in the confidential data destruction, acquired in 1997 and 1998 20% and 10%, respectively, of Cycle-Tec Recycling Technologies Ltd. (Cycle-Tec), a research and development company which develops a process for manufacturing of a high strength / low cost composite material, based on recycled post consumer plastic and paper, treated with special chemical additives. As of May 31, 2007, Amnir owned 30.18% of Cycle-Tec.

5. In July 1998, the Company signed an agreement with a strategic partner, Compagnie Generale d Entreprises Automobiles (CGEA), for the sale of 51% of the operations of Amnir Industries and Environmental Services Ltd. (Amnir Environment) in the field of solid waste management (waste disposal and management of transfer stations and landfills). CGEA is an international French company, which is part of the Veolia group and one of the world's leading companies in the field of environmental services. The agreement did not apply to Amnir's operations in collecting and recycling paper and plastic. As of February 13, 2007, the Company is no longer a shareholder in Amnir Environment, see clause 6 below.

6. In March 2000, AIPM and CGEA, on the one hand, and Tamam Integrated Recycling Industries Ltd. (T.M.M.) and its controlling shareholders, on the other hand, entered into an agreement pursuant to which AIPM and CGEA acquired through a jointly held company, Barthelemi Holdings Ltd ( Barthelemi ) from T.M.M.'s controlling shareholders 62.5% of the share capital of T.M.M., an Israeli company in the solid waste management field. Simultaneously therewith, 100% of Amnir Environment's shares were transferred to T.M.M. in return for an allocation of 35.3% of the shares of T.M.M. to the shareholders of Amnir Environment. Following such transaction, AIPM and CGEA owned, together, 75.74% of the shares of T.M.M. In August and September 2000, T.M.M. acquired approximately 3% of its own share capital. In December 2001 and in August 2003 AIPM and CGEA acquired additional shares of T.M.M.'s share capital through the jointly held company Barthelemi, resulting in an increase in the ownership of shares of T.M.M. by AIPM and CGEA to 88%, and as of December 31, 2006, AIPM held directly and indirectly 43.08% of T.M.M.'s shares and CGEA held 44.92% of T.M.M.'s shares. On January 4, 2007, an Agreement was signed between the Company and CGEA, according to which, the Company sold to CGEA its holdings in Barthelemi, and the rest of its holdings in T.M.M. The aforesaid transaction, for the total amount of \$ 27 million, was accomplished in February 13, 2007, and since then, the Company is no longer a shareholder in T.M.M.

7. In June 2005, C.D. Packaging Systems Limited ( C.D., an associated company of AIPM, held jointly with Carmel), which is engaged, in the designing, manufacturing and marketing of consumers packages, acquired the business activity of Frenkel and sons Ltd., in exchange for allocation of shares in C.D., and was renamed to Frenkel- CD Ltd. Both companies are engaged in the field of folding boxes. The goal of the new entity is to join the activities in the field and create a significant entity in the competitive market, while combining the advantages of the two companies and fulfilling the potential of cost savings, as a result of the synergy between the activities. The merger is effective as of January 01 2006. As of May 31, 2007, the Group holds 35.16% of C.D.'s shares (directly and indirectly through Carmel that holds 27.85% of C.D.'s shares) and Frenkel and sons Ltd. holds 44.3% of C.D.'s shares.

### **Capital Expenditures and Divestitures**

#### **2006**

The investments in fixed assets totaled about NIS 53.1 million (about \$ 12.5 million). These investments included:

Investments of approximately NIS 3.0 million (\$ 0.7 million) in environmental expenditures.

An investment of approximately NIS 2.5 million (\$ 0.6 million) in a conversion to a conversion to gas system.

Investments of approximately NIS 13.9 million (\$ 3.3 million) in conversion and improvement of steam tanks.

Investments of approximately NIS 1.7 million (\$ 0.4 million) in real estate in Hadera as a reserve for the Company's future development.

Investments totaling NIS 32.0 million (\$ 7.5 million) in buildings, equipment, transportation and information technology.

#### **2005**

The investments in fixed assets totaled about NIS 71.1 million (about \$15.4 million). These investments included:

Investments of approximately NIS 4.6 million (\$1.0 million) in environmental expenditures.

An investment of approximately NIS 1.8 million (\$0.4 million) in a conversion to a gas system.

Investments of approximately NIS 36.8 million (\$8 million) in real estate in Hadera an Naharia.

Investments totaling NIS 27.9 million (\$6 million) in buildings, equipment, transportation and information technology.

**2004:**

The investments in fixed assets of the Company totaled about NIS 31.0 million in 2004 (about \$6.9 million). These investments included:

Investments of approximately NIS 2.2 million (\$0.5 million) in environmental expenditures.

An investment of approximately NIS 2.2 million (\$0.5 million) in a machine for the manufacturing of cores based on Cycle-Tec technology.

Investments totaling NIS 26.6 million (\$5.9 million) in buildings, equipment, transportation and information technology.

**B. Business Overview**

**I. The Group's Operations and Principal Activities**

The Company is engaged through its subsidiaries in the manufacture and sale of packaging paper, in the collection and recycling of paper and plastic waste and in the marketing of office supplies, mainly to the institutional and business sector. The Company also holds interests in associated companies that deal in the manufacture and marketing of printing and writing paper, household paper products, hygiene products, disposable diapers, complementary kitchen products, corrugated board containers and packaging for consumer goods.

In order to serve the paper production activities, the Company, through a wholly owned subsidiary, supplies engineering services, maintenance, steam and energy, water supply, sewage treatment etc. to different paper machines located at the Company's main site in Hadera in return for cost sharing.

The Company operates in its main production site in Hadera according to the following standards:

ISO 9001/2000 quality management

ISO 14001 environmental regulations

Israeli Standard 18001 - safety

The principal products produced and/or marketed by the Group (indicating its subsidiaries and associated companies) are as follows:

**Grades of Paper and Board**

Printing and writing paper, publication papers in reels, coated paper, carbonless paper, cut-size paper for copy laser and inkjet, copy-book paper, paper for continuous forms, paper for envelopes and direct mailing and various grades of packaging paper and board.

Packaging Products

Folding cartons, corrugated containers, consumer packages solid board containers and pallets.

Household Products

Bathroom tissue, toilet paper, kitchen towels, facial tissue, napkins, disposable tablecloths, sanitary towels, panty shields, tampons, disposable baby diapers, training pants, baby wipes, disposable adult diapers, incontinence pads.

Industrial, Hospital and Food Service Products

Toilet paper, towel rolls, C-fold towels, napkins, place mats, coasters, bed sheets, wadding, paper toilet seat covers, disposable bed-pans and urinals, sterilizing paper, bathroom tissue and paper towel dispensers, dispensers for liquid hand soaps and room deodorizing dispensers for washrooms and cleaners, detergents and cleaning complimentary products, cups and plates, examination gloves.

Other Products

Aluminum food wraps, cling-film wraps, garbage bags, oven baking and cooking trays, office supplies, recycled ground and palletized plastics used by the plastic products industry.

**Sales and Marketing**

The Group's packaging products are sold mostly to four main customers in Israel (one of them is an associated company) which operate in the corrugated board sector with whom the Group has long standing business relationships.

The Group's office supplies products are sold to thousands of customers in the Business to Business sector and to institutions such as governmental offices and banks. About 30% of the sales are made through tenders.

The Group's paper grades products are sold to publishers, big and medium size printers, converters, and wholesalers some of which are part of the Group, as well as other direct customers.

The Group's household products are marketed mainly through retail marketing chains, stores and the institutional market.

The Group's packaging products are sold to a wide range of customers in different sectors (e.g., industry, agriculture, food and beverage industry), including direct marketing to ultimate customers through subcontractors and agents.

The Group's main marketing strategy has the following objectives:

- (a) Maintaining its existing dominant share in the Israeli market of paper grades and household products produced by the Group and imported by it, through short delivery times and prompt service, while constantly improving the quality of its products.
- (b) Meeting the growing and changing requirements of the market by adding new products and improving the quality of existing grades of paper in order to meet the technological changes required by new printing equipment and the needs of the customers.
- (c) Exploring new business opportunities in Israel and abroad and increasing the range of its products and the production capacity.

In March 2007, KCTR signed a principles agreement with Unilever, according to which Unilever shall distribute and sell KCTR's products in Turkey, excluding distribution and sales to the food chains which will be done directly by KCTR. The agreement was signed to enable KCTR to increase its market cover and volume of sales, following the approval of a strategic plan by KCTR, for the expansion of its activities in Turkey for the coming decade. The complete strategic plan is designated to expand the activities of KCTR, from the current yearly sales turnover of \$50 million to a turnover of \$300 million in the year 2015, and improve its profitability through constructing it as a significant factor in the Turkish market in the field of disposable diapers, women hygienic products and various tissue products, based on international brands of Kimberly-Clark worldwide.

The following table sets forth the consolidated sales in NIS millions(\*\*) by categories of the consolidated segments of operations:

\*\* AIPM made the transition to reporting in nominal New Israeli Shekels (NIS) in 2004, pursuant to the directives of Standard 12 of the Financial Accounting Standards Board in Israel. Prior to January 1, 2004, AIPM's reports were in NIS, adjusted to changes in the exchange rate of the US dollar against the NIS.

<b>Packaging Paper Manufacturing and Recycling (1)</b>			<b>Marketing Office Supplies (2)</b>			<b>Total</b>		
<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
408.0	368.9	367.4	122.1	113.6	115.5	530.1	482.5	482.9

The above mentioned segments include the following activities:

1. Packaging paper manufacturing and recycling – manufacturing and marketing of packaging paper, including collecting and recycling of paper waste. The manufacturing of packaging paper relies mainly on paper waste as raw materials.
2. Marketing office supplies - Marketing of office supplies and paper, mainly to institutions.

### **Raw Materials**

The raw materials required for paper and board production are different wood pulps, secondary fibers (i.e., waste paper) and various chemicals and fillers. Pulp is imported primarily from major suppliers in Scandinavia, the United States, Portugal, Austria, Brazil and Spain on a regular basis. The bulk of the pulp tonnage purchased is secured by revolving long-term agreements renewed on a yearly basis. All of the pulp for the printing and writing paper manufactured by Mondi Hadera is purchased by Mondi Business Paper (the Austrian parent company), which purchases pulp for its subsidiaries around the world. This ensures fluent supply and better prices.

The pulp for the household products is being imported by H-K with the assistance of K-C.

About 65% of the fibers required in paper production by the Group (including printing and writing paper and household products for the operation of its associated companies) come from waste paper, which in some paper grades, is used in lieu of relatively more expensive pulp. The production of packaging and brown wrapping paper is based mostly on recycled fibers. Therefore, the main raw material used for the production of packaging and brown wrapping paper is paper waste most of which is collected from various sources by Amnir, a wholly owned subsidiary of the Company. Approximately 210,000 tons per year of waste paper are collected and handled by Amnir, most of which are used by the Group for the production of fluting and tissue paper and some of which is sold to other tissue paper manufacturers. Apart from the waste paper collected by Amnir there is a use of residue which is created during the production of packages and purchased from the manufacturers of corrugated board.

The absence of supporting enforcement of the Recycling Act, which mandates waste recycling, detracts from the company's ability to expand waste collection, due to financial considerations. On January 16, 2007, however, the Clean Environment Act (9th amendment) - 2007 (Clean Environment Act) was enacted, imposing a landfill levy on waste. Pursuant to the provisions of this act, a landfill charge will be levied against waste, at the rate of NIS 10 per ton in 2007, rising up to NIS 50 per ton from 2011 and thereafter. The enforcement of this act may lead to improved capacity in paper waste collection.

Also, Amnir is preparing to increase paper waste collection over the coming years, due to a board approval for an investment in a new machine for packaging paper, at a cost of approximately \$140 million (see also section D below). The construction of the new packaging machine, will require twice the volume of paper waste collection to serve as raw material in the production of packaging paper over the coming years. Amnir is gearing up to increase collection volumes, in anticipation of the installation of the new packaging paper machine. For further details please refer to the Item 4.D. Property, Plants and Equipment below.

The main raw material required for the manufacture of corrugated board is board paper. Carmel purchases paper from two main suppliers which are also shareholders of Carmel.

Since 1996, NHP, an associated company, has been using precipitated calcium carbonate (PCC), a special pigment used for filling and coating paper in order to improve quality. In 2005, an agreement was signed between Mondi Hadera and the Swedish company Omya International AG (Omya) for the supply of PCC for a period of ten years commencing in April 2006. The parties are currently negotiating for the extension of the Agreement to fourteen years in return for the reduction of the PCC cost. Omya constructed and operates a PCC plant in Israel. In September 2005, the Agreement was converted to an Israeli fully owned subsidiary of Omya. The PCC purchased from Omya replaced a former PCC purchase from another PCC supplier, and led to a significant PCC cost saving.

The cost of paper production is affected by fluctuating raw material prices and the cost of water, energy and fuel oil. At the associated companies, there exists exposure to the fluctuations in raw material prices and the prices of products purchased for imports that arrive in Israel with no tariffs and no entrance barriers. Unusual rises in the cost of raw materials and imported finished products could impair profitability.

### **Competition**

Most of the Group's products that are sold on the local market are exposed to competition with local and imported products. The imported products arrive in Israel exempt from import tariffs, especially from the EEC, EFTA and the USA. The tariffs on imports of fine paper from other countries are in the range of 0% - though 12%.

The main competitors of the Group in the different fields of operation are Israeli companies which sell mainly imported products, except for sales of baby diapers and hygienic products in which the Group's main competitor is Proctor & Gamble Co.

In the market for office supplies that are sold directly to institutions and businesses there are numerous local suppliers that compete with the Company.

The sector of office supplies with direct delivery to organizations and businesses includes two dominant competitors (Office Depot and Kravitz), which together with Graffiti primarily dominate the tender and strategic business customer segment; and number of competitors which have a combined together on approximately 20% market share. In addition, in the business big/ medium/ small a large number of competitors exists, and which mostly operate within a limited geographical area. In late 2006 and early 2007, several General Accountant tenders were issued for office supplies and consumables office supplies; the tenders were secured by Office Depot, whose market share is therefore expected to grow to about 11%. Graffiti and Kravitz each possess an estimated 10% market share after implementation of the General Accountant tenders. Below is a listing of major competitors: Kravitz, Office Depot, Ofek, Alpha Beta, Yavne Pitango, Pythagoras, Lautman and Pan. Graffiti competes and maintains its position by adhering to elevated standards of quality and service.



The Group collection and paper recycling operation is exposed to local competition by local companies which operate all over the country.

The competition has influence over the selling prices that the Group can charge. The Group competes with the imported products by emphasizing the advantages of having a local supplier by ensuring the customers uninterrupted supply and service on short notice and excellent quality of products.

Competition in packaging paper is against imports, made directly by customers with no barriers. Imports into Israel include all paper types produced in Israel at different paper qualities, depending on the supplier's production machinery. To the best of the Company's knowledge, the primary overseas suppliers include: Varel Germany, Emin Leidlier France, Saica Spain, Hamburger Austria, SCA Italy, Otor France. The sector competes by ensuring continuous supply and service with short lead times, which provide it with the advantage of a local supplier.

The Company operates in a competitive market, with competition in the paper and recycling sector against imported paper on the one hand, and with many collectors operating in raw material collection in Israel.

Company's operations depend to a great degree on energy consumption, and are therefore strongly impacted by fuel prices. Profit margins may be eroded if fuel and electricity prices surge.

In December 1989, the Company was declared a monopoly in the manufacture and marketing of packaging paper by the Israel Antitrust Authority- there are no special provisions for the packaging paper.

Regarding seasonality of the Company's business, H-K products are generally sold on a regular scale all year round, and during the Jewish holiday season (Rosh Hashanah, Passover), there is some increase in the scope of sales beyond the ordinary monthly average.

### **C. Organizational Structure**

As of May 28, 2007, Clal Industries and Investment Ltd. (Clal) beneficially owned 37.83% of the ordinary shares of the Company and Discount Investment Corporation Ltd. (DIC) beneficially owned 21.37% of the ordinary shares of the Company. Clal and DIC agreed to coordinate and pool their voting power in the Company. To our knowledge, IDB Development Corporation Ltd. owns 74.76% of DIC and 60.52% of Clal. See Item 7 - Major Shareholders and Related Party Transactions.

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**Significant subsidiaries and associated companies**


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Name of the Company	Ownership and Voting	Country of Incorporation
<b><u>Subsidiaries</u></b>		
Amnir Recycling Industries Ltd.	100.00%	Israel
Graffiti Office Supplies & Paper Marketing Ltd.	100.00%	Israel
Attar Marketing Office Supplies Ltd.	100.00%	Israel
American Israeli Paper Mills Paper Industry (1995) Ltd.	100.00%	Israel
<b><u>Associated Companies</u></b>		
Hogla-Kimberly Ltd.	49.90%	Israel
Kimberly -Clark Tuketim Mallari Sanayi Ve Ticaret A.S. ("KCTR") (held through H-K)	49.90%	Turkey
Mondi Business Paper Hadera Ltd.	49.90%	Israel
Barthelemi Holdings Ltd.**	35.98%	Israel
T.M.M. Integrated Recycling Industries Ltd. (direct and indirect)**	43.08%	Israel
Carmel Containers Systems Ltd.	36.02%	Israel
Frenkel- CD Ltd. (direct and indirect through Carmel)	35.16%*	Israel
Cycle-Tec Recycling Technology Ltd.	30.18%	Israel

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\* The holding in voting shares is 35.11%.

\*\* Until February 2007.

**D. Property, Plants and Equipment**

The Group's principal executive offices and manufacturing and warehouse facilities (including associated companies) are located on approximately 87.5 acres of land in Hadera, Israel, which is 31 miles south of Haifa, a major seaport, 28 miles north of Tel Aviv. The Company owns 69.5 acres, out of which 18.5 acres were purchased in 2005, for the amount of \$4.4 million, and 18 acres are leased from the Israel Land Administration, an agency of the State of Israel, under several leases. The lease periods terminate during the period from 2007 until 2053. Some of this land is rented to associated companies, which operate in Hadera.

The Group's facilities in Hadera are housed in two-story plants and several adjoining buildings. Approximately 1,200,000 square feet are utilized for manufacturing, storage and sales and administrative offices. An additional plant owned by H-K is located in a 10-acre plot in Afula, a city in northern Israel. AIPM is leasing from the Israel Land Administration in Nahariya, in northern Israel, approximately 6 acres, which are rented to an associated company. In September 2002, the Company signed an agreement with the Tel Aviv Municipality for the extension of the lease period of a real estate lease for a plant in Tel Aviv, that was shut down at the end of 2002, until the year 2059, in return for the payment of \$6.2 million by the Company. The Company is investigating several options for using the land. According to the lease Agreement, the Company is obliged to utilize its building permits until September 2009.

The Group also owns a two-acre parcel in the industrial zone of Bnei Brak, near Tel-Aviv, which is used for waste paper collection.

The Group owned a warehouse containing 50,000 square feet situated on approximately 3.1 acres in the Tel Aviv area, leased from the Israel Land Authority and rented to third party under a long term agreement. On December 31, 2006, the Company sold its lease rights to this land to Erledan Investments Ltd. in consideration of NIS 57 million, including betterment taxes that apply to the buyer, so that the net worth to the Company before betterment taxes is about NIS 43 million. As a result of this sale, the Company recorded capital gains of some NIS 28.5 million in the fourth quarter of 2006.

H-K's headquarters and logistic center, which are leased under a long term lease agreement, are located in a new modern site in Zrifin, near Tel-Aviv, covering an area of 430,550 square feet, with 188,370 square feet of buildings.

Associated companies rent plants and office facilities in Migdal Haemek and Caesarea and additional warehouses and waste paper collection sites throughout Israel.

The machinery, equipment and assets of the Company are free of any mortgage, lien, pledge or other charge or security interest.

The Group owns six paper machines that are used in the manufacture of various grades of paper and board. Most of the paper production facilities of the Company and its subsidiaries are located in Hadera where it operates five machines with a combined production capacity of over 320,000 tons per year. The Group owns another machine in Nahariya which produces tissue paper with production capacity of 20,000 tons per year.

In November 2006, the Company's Board of Directors approved a total investment of approximately \$140 million in the construction project of a new machine for the manufacture of packaging paper from cardboard and paper waste, with an output capacity of 230,000 tons per annum, at the Company's site in Hadera. Subsequent to the construction of the new machine, planned for 2009, and along with the parallel decommissioning of one of two machines currently operating, the Company's annual production capacity for packaging paper will increase from 155,000 tons at the present time, to approximately 330,000 tons per annum. The new machine is meant to answer the need for ever-increasing demand volumes by the local market, at competitive pricing vis-à-vis the competing importer. The Company has yet to decide how it will finance the project and is currently analyzing various alternatives.

The new machine is intended to meet the Company's need for ever-increasing demand volumes by the local market, at competitive pricing vis-à-vis the competing importer. The Company anticipates that the significant growth that is planned in the total volume of its paper production, on the basis of the existing infrastructure, will serve to improve its long-term profitability. The Company has yet to decide how it will finance the project and is currently analyzing various alternatives.

The Group also operates converting lines for personal care and household paper products in Hadera and Nahariya.

The Group maintains facilities for collecting, sorting and baling waste paper and board in various locations in Israel. It also has a plant in Afula for the production of disposable baby diapers, incontinence absorbent products and feminine hygiene products, a plant in Migdal Haemek for the production of paperboard consumer packages and a plant in Hadera for recycling plastic waste.

The Company established in 2000 a new co-generation power plant, based on high-pressure steam available from steam drying employed in paper production, for a total investment of about \$14 million. The operation of the power plant, situated in Hadera, and the Group now enjoys an independent power generation capacity of 18MW, with generation costs considerably lower than the cost of electricity purchased from the Israel Electricity Company. As part of this project, the infrastructure of the main electricity supply system was renovated and improved, utilizing modern technological innovations.

The Company is examining and promoting a project for establishing a combined cycle co-generation plant based on natural gas at Hadera. In addition, the Company is preparing for the conversion of its energy-generation systems, currently based on heavy fuel oil, to natural gas, once the transportation infrastructure of natural gas to Hadera is completed. The conversion is planned for the third quarter of 2007. This conversion is expected to enable savings in production costs, while further improving environmental compliance. The capacity of the new plant is expected to enable the Company to sell electricity to external users, including the Israel Electric Company.

In October 2004, a wholly owned subsidiary of the Company, American Israeli Paper Mills Paper Industry (1995) Ltd., was granted by the Minister of National Infrastructure a basic permit to generate electricity by means of power and heat systems (co-generation). In addition, in December 2004 the project was announced as a National Infrastructure Project .

The permit in principle enables the Company to build a power station with a total output of 200 megawatts, with integrated cycle cogeneration, operating on natural gas, at the AIPM site in the Hadera Industrial Zone. The said authorization is contingent upon several conditions that have yet to be met, including meeting the production license requirements, the demands of the Electricity Economy Law, certain milestones outlined in the authorization and more.

In October 2006, the National Infrastructure Committee approved the change in designation of 40,000 m(2) of land, to be used as a power station and for other uses. The approval was empowered by the Israeli government on February 6, 2007.

#### Environmental Regulation Matters

The business license of the main production site of the Group in Hadera includes conditions regarding sewage treatment, effluent quality, air quality and the handling of waste and chemicals. In addition, the site has to operate according to the conditions of the Israeli water commission regarding effluent disposal. To the best knowledge of the Company, the site operates according to the requirements of the authorities, and in the events of deviations, the Company acts for the repairment of the deviations, jointly with the authorities.

In November 2006, the Environmental Protection Ministry announced that, even though the Company plant at Hadera has made considerable investments in sewage treatment and environmental protection issues, an investigation may be launched against it to review deviations from certain emission standards into the air. The Company anticipates that the investigation will not materially impact its operations.

Certain of the Group's manufacturing operations are subject to environmental and pollution control laws in Israel. In order to comply with these laws, the Group planned and acquired, during 2001, a new modern facility for the treatment of effluent using an anaerobic treatment process. This process was installed in the Group's site in Hadera as a pre-treatment phase in the existing system based on aerobic treatment, in order to improve the treated effluent quality in compliance with environmental regulations.

During the years 2000-2006 the Group invested in Hadera approximately \$11.6 million in projects intended to enable it to comply with the strict environmental regulations applicable to it out of which: about \$5 million in 2006, including a \$3.5 million investment in the conversion of the energy system to consume natural gas instead of fuel oil as described below, and \$800,000 in a project for a waste water softening facility in the treatment facility, to serve as a basis for recycling treated waste water, as well as investments in sewage, chemicals and waste, including systems for collection and separation of waste and sewage incorporating tertiary treatment of treated waste water.

The Company is preparing for the conversion of its energy-generation systems, currently based on heavy fuel oil, to natural gas, in an investment of approximately \$7million (out of which about \$3.5 million in 2006). This process will be completed with the completion of the installation of the natural gas pipeline to Hadera , postpones due to delays that lie outside the control of the Company, and planned for the third quarter of 2007. This project is expected to contribute saving expense and improve the environmental compliance since the Company will use natural gas instead of fuel oil.

In 2006 all plants at the main Hadera site successfully passed various environmental inspections.

#### **ITEM 4A UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

##### **Critical Accounting Policies and Estimates**

The Company's discussion and analysis of the financial condition and operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in Israel (for information as to the reconciliation between U.S. and Israeli GAAP, see Item 17). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

The Company identified the most critical accounting principles upon which its financial status depends. The Company determined the critical principles by considering accounting policies that involve subjective decisions or assessments.

The Company states its accounting policies in the notes to the consolidated financial statements and at relevant sections in this discussion and analysis.

This discussion and analysis should be read in conjunction with the Company's consolidated financial statements and related notes included elsewhere in this report.

The Company identified the following critical accounting policies:

##### **Inventories**

Inventory is valued at the lower of cost or market, where cost is determined on the moving average basis. The Company writes down its inventory for estimated obsolescence or unmarketable inventory based on an analysis of the inventory aging and assumptions about future demand and market conditions. If actual demand and/or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Spare parts of the machinery and equipment that are not for current use, are presented under fixed assets.

##### **Allowance for doubtful accounts**

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company provides an allowance for doubtful accounts as a percentage of all specific debts doubtful of collection. The allowances are based on the likelihood of recoverability of accounts receivable considering the aging of the balances, the Company's historical write-off experience, (net of recoveries), change in credit worthiness of the customers, and taking current collection trends that are expected to continue. These estimated allowances are periodically reviewed, and customers' payment histories analyzed. Actual customer collections could differ from the Company's estimates.



Contingencies and risks involving the business

The Company is subject, from time to time, to various claims arising in the ordinary course of operations. In determining whether liabilities should be recorded for pending litigation claims, the Company assesses, based on advice of its outside legal counsel, the allegations made and the likelihood that it will successfully defend itself.

When the Company believes that it is probable that it will not prevail in a particular matter, it then estimates the amount of the liability. The evaluation of the probability of success of such claims and the determination of whether there is a necessity to include provisions in respect thereof require judgment by the Company's legal counsel and management.

Deferred income taxes

Deferred taxes are determined utilizing the asset and liability method, based on the differences between the amounts presented in the financial statements and those taken into account for tax purposes, in accordance with the related tax laws. Valuation allowances are included in respect of deferred tax assets when it is more likely than not that such assets will not be realized. The Company has considered future taxable income and tax planning strategies in assessing the need for the valuation allowance. Management evaluates the realizability of the deferred tax assets on a current basis. If it were determined that the Company would be able to realize the deferred tax assets in excess of its net recorded amount, an adjustment to deferred tax assets would increase income.

Impairment in value of Long-Lived Assets (including fixed assets and investments in associated companies)

In February 2003, Accounting Standard No. 15 of the Israeli Accounting Standard Board (hereafter - IASB) - Impairment of Assets, became effective. According to this standard the Company assesses - at each balance sheet date - whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of non-monetary assets, mainly fixed assets and investments in associated companies. When such indicators of impairment are present, the Company evaluates whether the carrying value of the asset is recoverable from the cash flows expected from that asset. See Note 2g to the Financial Statements.

The recoverable value of an asset is determined according to the higher of the net selling price of the asset or its value in use to the Company. The value in use is determined according to the present value of anticipated cash flows from the continued use of the asset, including those expected at the time of its future retirement and disposal.

When it is not possible to assess whether an impairment provision is required for a particular asset on its own, the need for such a provision is assessed in relation to the recoverable value of the cash-generating unit to which that asset belongs.

Through December 31, 2002, the Company applied the provisions for assessing and recording impairment of assets, prescribed by the U.S. standard, FAS 121.

Discontinuance of Adjusting Financial Statements for Inflation

The Company draws up and presents its financial statements in Israeli currency (hereafter - shekels or NIS), in accordance with the provisions of Israel Accounting Standard No. 12 - Discontinuance of Adjusting Financial Statements for Inflation - of the IASB, which establishes principles for transition to nominal reporting, commencing January 1, 2004 (hereafter - the transition date). Accordingly, amounts that relate to non-monetary assets (including depreciation and amortization thereon), investments in associated companies (see also below) permanent investments, and equity items, which originate from the period that preceded the transition date, are based on the data adjusted for the changes in the exchange rate of the dollar (based on the exchange rate of the dollar at December 31, 2003), as previously reported. All the amounts originating from the period after the transition date are included in the financial statements at their nominal values.

The financial statements of group companies which are drawn up in foreign currency, are translated into shekels or are remeasured in shekels for the purpose of inclusion in these financial statements, as explained in e. below.

The sums of non-monetary assets do not necessarily reflect the realization value or an updated economic value, but rather only the reported sums of the said assets, as stated in (1), above. The term "cost" in these financial statements shall mean the cost in reported sums.

#### Financial Instruments

In August 2005, the IASB issued Israeli Accounting Standard No. 22 "Financial Instruments Disclosure and Presentation" (herein after Standard 22). Commencing January 1, 2006, the Company applied Standard No. 22, which prescribes the rules for presentation of financial instruments and the proper disclosure required therefore, as follows:

1) Offset of financial instruments

Financial assets and financial liabilities are presented on the balance sheet at their net amount, only when the Company has a legally enforceable right to effect such set off, and subject to the existence of an intent to settle the asset and the liability on a net basis, or to realize the asset and settle the liability simultaneously.

2) In accordance with the transitional provisions of Standard 22, commencing January 1, 2006, in addition to the aforesaid, the financial statements include the following changes:

The balance of deferred issuance costs, which at December 31, 2005 amounted to NIS 946,000, has been reclassified and presented as a deduction from the amount of the liabilities to which such expenses relate. Through December 31, 2005, deferred issuance costs were included under other assets and amortized according to the straight-line method.

The change in the amortization method of deferred issuance costs, as above, does not have a material effect on the operating results in the reported years.

#### Revenue Recognition

In January 2006, Accounting Standard No. 25 of the IASB - "Revenue", became effective. The standard prescribes recognition, measurement, presentation and disclosure criteria for revenues originating from the sale of goods purchased or manufactured by the Company.

Revenue is measured, as detailed below, at the fair value of the consideration received or the consideration that the Company is entitled to receive, taking into account trade discounts and/or bulk discounts granted by the entity:

Revenue from sale of goods is recognized when all the following conditions have been satisfied: (a) the significant risks and rewards of ownership of the goods have been transferred to the buyer; (b) the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the Company; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.



Upon the application of the standard, an associated company separates the financing component embedded in revenue from sales made on credit for periods exceeding the customary credit period in its industry (mainly 90 days), that does not bear interest at the appropriate rate; the financing component is determined according to the amount by which the nominal amount of consideration for the transaction exceeds the present value of future cash payments in respect thereof, based on the customary market interest rate applicable to credit extended under similar terms. Revenue from the financing component is recognized over the credit period. Through December 31, 2005, the Company did not separate the financing component in respect of sales made on credit, as above, and included within revenue from the sale on the date of recognition of such revenue. In accordance with the transitional provisions of the standard, on January 1, 2006 the Company recognized an expense of NIS 1.1 million as a result of presentation in present value, resulting from the adjustment of trade receivables in respect of such credit transactions to their present value on the effective date of the standard, the share of the Company at the adjustment effect as above was approximately NIS 0.5 million which is presented in these financial statements under Cumulative effect, at beginning of year, of an accounting change.

#### Share Based Payment

In January, 2006, Accounting Standard No. 24 of the IASB, Share-Based Payment became effective. The standard prescribes the recognition and measurement principles, as well as the disclosure requirements, relating to share-based payment transactions.

Since the Company has not granted any equity-settled awards, nor made modifications to existing grants, subsequent to March 15, 2005, the measurement criteria of the standard do not apply to past grants made by the Company, and its application has not had any effect on the comparative figures included in these financial statements.

#### Net Income per Share

In January 2006, Accounting Standard No. 21 of the IASB, Earnings per Share became effective. The computation of basic net income per share is generally based on earnings available for distribution to holders of ordinary shares, divided by the weighted average number of ordinary shares outstanding during the period.

In computing diluted net income per share, the weighted average number of shares to be issued, assuming that all dilutive potential shares are converted into shares, is to be added to the average number of ordinary shares used in the computation of the basic income (loss) per share. Potential shares are taken into account, as above, only when their effect is dilutive (reducing net income per share from continuing activities).

Comparative net income per share figures included in these financial statements reflect a retrospective application of the new standard's computation directives.

As to the data used in the computation of net income per share, as above - see Note 11 to the Financial Statements.

As for information regarding the effects of new Israeli accounting standards see Note 1s to the Financial Statements.

#### Effects of Prior Year Misstatements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Financial Statements Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, or SAB 108. SAB 108 requires companies to quantify the impact of all correcting misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. SAB 108 is effective for fiscal years ending after November 15, 2006. We initially applied the provisions of SAB 108 using the cumulative effect transition method in our annual financial statements for the year ending December 31, 2006 in connection with our accounting treatment for various misstatements the cumulative effect of which on our retained earnings as at December 31, 2005 totaled NIS 2,665 thousand net of tax.

#### General

On March 7, 2006, T.M.M (an associated company) announced that the Israeli Securities Authority had addressed T.M.M. with regard to an investigation the authority is conducting. At this stage, T.M.M. is unable to estimate the impact of the investigation on the Company. On January 4, 2007, the Company sold all its holdings in T.M.M. (See Item 4A History and Development of the Company above).



On April 15, 2007, at a General Meeting the shareholders approved the appointment of Brightman Almagor & Co as the Company's external auditors for the year 2007. Brightman Almagor & Co will replace Kesselman & Kesselman & Co who served as the Company's external auditors since 1954.

**A. Operating Results**

The following is a summary of the period-to-period changes in the principal items included in the Consolidated Statements of Income:

**Amount and Percentage Increase (Decrease)**

New Israeli Shekels (in thousands)<sup>(1)</sup>

	Year ended 12/31/06 v. year ended 12/31/05		Year ended 12/31/05 v. year ended 12/31/04	
	Changes NIS	%	Changes NIS	%
Net sales	47,648	9.9	(393)	(0.1)
Cost of sales	35,546	9.3	7,275	1.9
Gross profit	12,102	12.2	(7,668)	(7.2)
Selling, administrative and general expenses	4,939	8.8	*3,432	6.5
Income from ordinary operations	7,163	16.5	(11,100)	(20.4)
Financial expenses (income) - net	18,621	149.1	(628)	(4.8)
Other income	32,861	739.4	4,952	974.8
Income before taxes on income	21,403	60.6	(5,520)	(13.5)
Taxes on income	10,711	178.8	2,839	90.1
Income from operation of the Company and the consolidated subsidiaries	10,692	36.5	(8,359)	(22.2)
Share in profits (losses) of associated companies	(42,616)	(259.6)	(8,658)	(34.5)
Cumulative effect, at beginning of year of an accounting change in an associated company	(461)			
Net income	(32,385)	(70.8)	(17,017)	(27.1)

The statements of income for the years ended December 31, 2006, 2005 and 2004 are presented in New Israeli Shekels as explained in note 1 to the Financial Statements.

The number of New Israeli Shekels which were exchangeable for 1 U.S. dollar increased (decreased) over the prior year by (-1.6%), 6.8% and (-8.2%) in 2004, 2005 and 2006, respectively. See Note 1 to the Financial Statements attached and Item 17 Financial Statements for the anticipated effect of adopting of accounting pronouncements that have been issued but are not yet adopted.

\* The change in selling administrative and general expenses of NIS 3,432 was reclassified in the years 2005 and 2004.

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AIPM made the transition to reporting in nominal New Israeli Shekels (NIS) in 2004, pursuant to the directives of Standard 12 of the Financial Accounting Standards Board in Israel. In the past AIPM's reports were in NIS, adjusted to changes in the exchange rate of the US dollar against the NIS.

## **2006 Compared to 2005**

### **I. Overview of Results of Operations**

#### **1. Consolidated Data**

Consolidated sales in 2006 amounted to NIS 530.1 million, as compared with NIS 482.5 million in 2005, representing growth of approximately 10%.

The consolidated operating profit amounted to NIS 50.5 million in 2006, as compared with NIS 43.3 million in 2005, representing growth of approximately 17%.

Profit after taxes and before AIPM's share in earnings of associated companies for 2006, amounted to NIS 40.0 million, as compared with NIS 29.3 million in 2005.

#### **2. Net Profit and Earnings Per Share**

Net profit in 2006 amounted to NIS 13.3 million, as compared with NIS 45.7 million in 2005.

Net profit this year was affected by the growth in the Company's share in the losses of the operations in Turkey (KCTR), amounting to NIS 41.9 million (see Section C7 in this Item 5, below).

Net profit in 2006 included a net capital gain from the sale of real estate at Atidim in the sum of NIS 28.5 million, and non-recurring expenses (net of taxes) of NIS 18 million, primarily on account of a provision for impairment at an associated company (in the third quarter of the year) and the impact of the devaluation and modified tax rates in Turkey (in the second quarter of the year- approximately NIS 8 million included in the loss of the operations in Turkey).

Basic earnings per share amounted to NIS 3.31 per share in 2006 (\$0.81 per share), as compared with NIS 11.43 per share in 2005 (\$2.48 per share).

The diluted earnings per share amounted to NIS 3.28 per share in 2006 (\$0.77 per share), as compared with NIS 11.35 per share in 2005 (\$2.46 per share).

### **II. The Business Environment**

In 2006, the accelerated growth in the Israeli economy continued (5%), along with growing demand in the public sector and growth in private consumption.

Although the Second Lebanon War in the summer of 2006 led to a slowdown in economic activity during the war. The economy, however, rapidly recovered and returned to the accelerated growth rate that existed before the war.

The Company's results continued to be effected by high energy prices primarily fuel oil, whose prices rose by an aggregate 70% in 2005 and 2006 as compared to 2004 (38% in 2005 and 22% in 2006), while diesel prices rose by an average of 29% during the same period.

The impact of rising energy prices on the aggregate operating profit of the Company amounted to approximately NIS 22 million.

At the same time, the prices of the main raw materials utilized by the Group in their various activities also continued to rise.

The impact of rising raw material prices on the aggregate operating profit of the Company amounted to approximately NIS 46 million.

The recovery that began in Europe's paper industry, which closed the gap between paper supply and demand, was slow and has not yet fully translated into a decrease in competing imports into Israel. As a result it has been difficult to raise selling prices—primarily those of fine paper, as warranted by the said rise in input prices.

### **General**

The Group dealt with the increased input prices by implementing a range of activities. These activities included raising prices vis-à-vis the competition to the extent possible and intensifying the efficiency measures implemented with respect to all its expense components. The efficiency measures implemented by the Group in 2006 led to cost savings in the amount of approximately NIS 27 million.

As part of the said operations, the Company is initiating measures to achieve synergies between the Group's companies, so as to allow for efficiency and cost-cutting, including energy and raw material costs. Among other measures, this was reflected in a fuel purchase agreement that allowed for significant savings, while capitalizing on the Group's economies of scale. The said measures also include the anticipated savings from the completion of the anticipated conversion to the use of natural gas at the Hadera plant, as described below.

At the same time, the Group continues to implement a number of cross organization plans including the following: the talent management program for the development of the Group's managers and the creation of a managerial reserve; the WOW Program, for enhancing the customers perceived added value of the Company's products and improving the loyalty premium and the price based on a differentiation of products and service; and Kimberly Clark's global center lining program, aimed at improving production-line efficiency (applying a methodology that creates a common basis for all factors influencing operation of the machines, such as engineering, maintenance, technology and operations, while continuously measuring the variance of the selected parameters, creating a process of constant improvement in both quality and costs). These programs have already borne the first fruits in 2006 and the Company is continues to implement the plans at all the Group's companies in order to exploit their full potential in the coming years.

The Group is also currently continuing its efforts to improve selling prices, on the one hand, while extending the efficiency measures on the other hand, in order to compensate for the said rise in input prices.

It is impossible to estimate the influence of the above operations on the Group's profitability, at this stage.

As part of the Company's efforts to cut production costs and achieve further improvements in environmental quality, the Company is continuing to promote the project for the establishment of a co-generation plant in Hadera, using natural gas.

The Company has taken the initial steps to convert its energy generation facilities from the use of fuel oil to natural gas. This process will be completed with the completion of the natural gas pipeline to Hadera, planned for the third quarter of 2007.

In connection therewith, the Company signed an agreement in London on July 29, 2005, with the Tethis Sea Group, for the purchase of natural gas. The gas that will be purchased is intended to supply the Company's requirements in the coming years, for the operation of the existing energy co-generation plant at the Hadera plant, that will be converted for the use of natural gas, instead of the current use of fuel oil. The overall financial volume of the transaction totals about \$35 million over the term of the agreement (5 years from the commencement of the gas flow, but no later than July 1, 2011).

The conversion from fuel oil to gas will enable significant savings in fuel costs, estimated at approximately \$8.5 million per annum, due to the significant differences between the current prices of fuel oil and gas, and will enhance the Group's competitiveness and profitability.

The exchange rate between the NIS and the US dollar was revalued by a further 8.2% in 2006, as compared to a 6.8% devaluation in 2005.

The inflation rate in 2006 amounted to 0%, as compared with an inflation rate of 2.4% in 2005.

### **III. Analysis of Operations and Profitability**

The analysis set forth below is based on the consolidated data.

#### **1. Sales**

Consolidated sales amounted to NIS 530.1 million in 2006, as compared with NIS 482.5 million in 2005 and NIS 482.9 million in 2004.

The growth in sales in 2006 included increases in sales in both the packaging paper and recycling sector, as well as the office supplies sector.

The change in sales in 2005 in comparison to 2004, originated primarily from a certain growth in the sales of packaging paper and recycling, along with an immaterial decrease in the office supplies sector, following the implementation of a reorganization in this sector.

#### **2. Cost of Sales**

Cost of sales amounted to NIS 418.7 million in 2006, representing 79.0% of sales, as compared with NIS 383.2 million, or 79.4% of sales in 2005 and as compared with NIS 375.9 million, or 77.9% of sales in 2004.

The gross margin grew to 21.0% of sales in 2006, as compared with 20.6% in 2005 and 22.1% in 2004.

The principal factors that affected the material changes in gross profitability in 2006, as compared with 2005 consisted of a certain increase in raw material prices and an unusual rise in energy prices (fuel oil by 22%).

The rising prices in packaging paper and recycling and the quantitative increase in sales primarily in office supplies sector together with the continuing efficiency, resulted in an improvement in the consolidated gross margin in 2006.

The gross margin eroded in 2005 as compared to 2004 as a result of the unusual increase in energy prices (approximately 38%), raw material prices and other inputs. These price hikes were not fully compensated for by an increase in selling prices, due to prevailing market conditions.

#### **Labor Wages**

The labor wages in the cost of sales, in selling, general and administrative expenses, amounted to approximately NIS 162.2 million in 2006, as compared with NIS 149.7 million in 2005 and NIS 137.0 million in 2004.

The increase in wages in 2006 originated mostly from an increase in personnel primarily at Amnir as part of the preparations for an expansion in collection volumes, in anticipation of the establishment of the new paper manufacturing array.

#### **3. Selling, General and Administrative Expenses**

The selling, general and administrative expenses (including wages) amounted to NIS 60.9 million in 2006 (11.5% of sales), as compared with NIS 55.9 million (11.6% of sales) in 2005 and NIS 52.5 million in 2004 (10.8% of sales).

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The increase in selling, general and administrative expenses originated partially from a certain increase in labor expenses, coupled with non-recurring expenses (approximately NIS 2 million), included in the expenses this year.

#### **4. Operating Profit**

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The operating profit amounted to NIS 50.5 million in 2006, representing growth of 17% as compared with 2005, and comprised 9.5% , 9.0% and 11.3% of sales in 2006, 2005 and 2004 respectively.

The increase in operating profit in 2006, in a rate of 17% as compared with 2005 originated from the increase in sales of packaging paper and recycling, primarily on account of the improvement in selling prices and the efficiency measures, that were partially offset by rising energy prices, coupled with the improvement in the operating profit of the office supplies sector as a result of efficiency measures and the reorganization that the Company initiated in the past several years.

In the office supplies sector, the transition to operating profit in 2006, as compared with an operating loss in 2005, was attributed to the reorganization in the sector, accompanied by far-reaching efficiency measures and steps to increase sales, following the decrease of the operating loss in 2005 as compared with 2004 (NIS -0.9 million in 2005, as compared with NIS -4.6 million in 2004).

### 5. Financial Expenses

Financial expenses amounted to NIS 31.1 million in 2006, as compared with NIS 12.5 million in 2005 and NIS 13.1 million in 2004.

The total average of the Company's net, interest-bearing liabilities grew by an average of approximately NIS 160 million in 2006, compared to 2005 and 2004. The increase resulted primarily from investments in fixed assets and dividends distributed in 2006, net of dividends received from associated companies and the positive cash flows from operating activities.

Moreover, the costs of hedging the Series 2 notes against a rise in the CPI has risen to 1.8% per annum in 2006, as compared with 1.3% per annum in 2005 and resulted in an increase in costs related to the notes.

During 2006 hedging transaction was made at a cost equal to 1.8%, and a 0.1% decrease in the CPI led during 2006 to additional financing costs of NIS 4 million being incurred on account of the CPI-linked notes.

In addition to the above, the sharp revaluation in 2006 of the New Israeli Shekel against the U.S. dollar served to increase the financial expenses on account of the surplus of dollar-denominated assets over dollar-denominated liabilities held by the Company, as compared with the devaluation recorded in 2005 (revaluation of 8.2% in 2006, as compared with a devaluation of 6.8% in 2005), also resulted in an increase in financial expenses in 2006.

### 6. Taxes on Income

Expenses for taxes on income from current operations totaled approximately NIS 5.5 million in 2006, as compared with NIS 10.2 million in 2005 and NIS 13.2 million in 2004.

The principal factors responsible for the decrease in tax expenses from current operations in 2006 as compared with 2005, are both the decrease in the profit from current operations before taxes this year, and the impact of the lower tax rate on current and deferred taxes this year, in relation to last year.

Moreover, the tax expenses in 2006 included an additional tax expense of NIS 11.2 million, primarily on account of the betterment tax realized on the sale of real estate. A tax benefit of NIS 4.2 million was recorded in 2005 on account of the impact of the tax reforms that were passed by the Knesset in July 2005 (gradually lowering the corporate tax rate to 25% by 2010) on the Company's deferred taxes.

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In 2004, the financial statements included a tax benefit of NIS 10 million, on account of the impact of the change in the corporate tax rate and a benefit on account of the exercise of options by employees.

Total tax expenses amounted to NIS 16.7 million in 2006, as compared with NIS 6.0 million in 2005 and NIS 3.2 million in 2004.

### 7. Company's Share in Earnings (Losses) of Associated Companies



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The companies whose earnings are reported under this item (according to AIPM's holdings therein), primarily include: Mondi Hadera, Hogla-Kimberly, Carmel and T.M.M.

The Company's share in the earnings (losses) of associated companies amounted to NIS (26.7) million in 2006, as compared with NIS 16.4 million in 2005 and NIS 25.1 million in 2004.

The following principal changes were recorded as the Company's share in the earnings of the associated companies:

The Company's share in the losses of Mondi Hadera (49.9%) in 2006, grew by NIS 2 million in relation to last year. Last year, Mondi recorded a tax benefit of NIS 4 million (our share consists of NIS 2 million on account of the change in the corporate tax rate; without this benefit, no change would have been recorded in the Company's share as compared with last year). Mondi's quantitative sales increased in 2006 as a result of greater output capacity due to the improvements to the paper machine in 2005. The sharp rise in pulp prices in the course of the year (16%), rising energy prices (22%) and the continuing imports from Europe at low prices, served to erode the gross margin and harmed the operating profitability. The revaluation of the dollar and the lowering of interest rates served to lower the financial expenses and offset the erosion in the operating profit.

The Company's share in the net earnings of Hogla-Kimberly Israel (49.9%) increased by NIS 9.8 million in 2006, as compared with 2005. The operating profit of Hogla-Kimberly Israel grew from NIS 94 million to NIS 128 million. This increase is primarily attributed to the improvement in selling prices. In the course of the year, Hogla-Kimberly continued to improve selling prices and to expand the market share of premium products, where the profit margins are higher. In 2006, Hogla-Kimberly also continued its far-reaching efficiency measures, that further contributed to its profitability. This profitability was partially offset by the continuing increase in input prices in 2006 (primarily raw materials and energy).

The Company's share in the losses of KCTR, a wholly-owned consolidated subsidiary of Hogla-Kimberly (49.9%) grew by NIS 41.9 million in 2006, as compared with 2005. Over the past two years KCTR has been establishing the organizational infrastructure in Turkey, developing its sales and distribution network, and is continuing to upgrade the diaper production plant producing Huggies® premium disposable diapers. In 2006, KCTR began launching Kimberly Clark's international brands Huggies® and Kotex® on the Turkish market. The launch of the brands involves significant investments in advertising, sales promotion and listing fees for the organized retail chains. These investments led to continued growth and an increase of 30% in quantitative sales to the local market. However, the rising prices of raw materials on account of the sharp devaluation in local currency in 2006, the escalating competition against local manufacturers and the investments in launching the international brands all led to a significant increase in the operating loss. Furthermore, KCTR recorded an extraordinary expenditure of approximately NIS 16 million (the Company's 49.9% share - approximately NIS 8 million) on account of the effect of the reduction in the corporate tax rate from 30% to 20% on the tax asset created in the past several years at KCTR and due to the sharp 20% devaluation of the exchange rate of the Turkish lira relative to the US dollar.

The Company's share in the net earnings of the Carmel Group (26.25%) increased by NIS 2.0 million in 2006, as compared with 2005. The change in profit is attributed to the higher operating profit that increased from NIS 8.1 million to NIS 11.7 million. The improvement in the operating profit originated primarily from an increase in quantities, the rise in selling prices and the continuing efficiency measures. This improvement was partially eroded in the course of the year as a result of the continuing rise in energy and raw material prices. At the same time, financial expenses have decreased as a result of the revaluation of the dollar in 2006.

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The Company's share in the losses of T.M.M. (43.08%) increased by NIS 10.1 million in 2006, as compared with 2005. The factors that led to this increase in losses included primarily non-recurring expenses that were incurred during the year. These expenses included a loss on account of the cumulative impact at the beginning of the year, on account of the implementation of Standard 25, in the sum of NIS 1.1 million, a provision for impairment on account of a long-term loan granted to a third party in the amount of NIS 1.6 million, the cancellation of a tax asset created on account of carryover losses in the amount of NIS 2.2 million and the impairment of two transfer stations by NIS 12.5 million. The Company's total share in these expenses amounted to approximately NIS 7.5 million (incorporated above).

As mentioned above, the Company sold its direct and indirect holdings in T.M.M. in early 2007.

### **2005 Compared to 2004**

## **I. Overview of Results of Operations**

### **1. Consolidated Data**

Sales amounted to NIS 482.5 million during 2005, as compared with NIS 482.9 million in 2004.

Operating profit in 2005 amounted to NIS 47.8 million, as compared with NIS 53.9 million in 2004.

Profit after taxes and before AIPM's share in the earnings of associated companies for 2005, amounted to NIS 29.3 million, as compared with NIS 37.7 million in 2004.

### **2. Net income**

Net income amounted to NIS 45.7 million during 2005, as compared with NIS 62.7 million in 2004.

Net income during 2005 included a tax benefit of NIS 8 million (including the Company's share in the benefit of associated companies) on account of the impact of the tax law reforms that were passed by the Knesset (Israeli parliament) on July 25, 2005, that serve to gradually lower the corporate tax rate to a level of 25% by 2010.

The net income before non-recurring items mentioned above amounted to NIS 37.7 million in 2005, as compared with NIS 48.3 million in 2004.

Earnings per share in 2005 amounted to NIS 1,127 per NIS 1 par value (\$2.45 per share), as compared with NIS 1,544 per NIS 1 par value (\$3.58 per share) in 2004. The return on shareholders' equity amounted to 7.9% in 2005, as compared with 10.2% in 2004.

## **II. The Business Environment**

The year 2005 was characterized by economic growth in Israel (approximately 5%), increased demand on the part of the public sector and more moderate growth in private consumption.

The Group's results in 2005 were significantly affected by the unusual rise in energy prices, that began in 2004 and accelerated in 2005.

This price increase included fuel oil and diesel prices that rose by an extraordinary average of 38% in relation to 2004. Water and electricity prices also rose in 2005 as compared with 2004 (by an average of 10% and 13%, respectively).

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The impact of these price increases on the Group's aggregate operating profit results amounted to approximately NIS 40 million.

Simultaneously, the prices of the principal raw materials used by the Group companies in their various activities also continued to rise. The impact was an additional NIS 60 million to the Group's costs in the aggregated operations profit, compared with 2004.

The downturn in the European paper industry, originating from surplus supply due to the recession, has resulted in competing imports into Israel, at low prices, which rendered it impossible for the Group to raise prices, as warranted from the said rise in input prices.

In view of the said market conditions and the fierce competition which the Group is facing, and with the intention of dealing with the said rise in input prices, the Group accelerated its efficiency programs at all its companies, intensively cutting costs across all expense areas at the same time maintaining the quality of products and the market share figures.

To cut costs, the Company is initiating measures to achieve synergy between the Group companies, thereby allowing the Group to enjoy economies of scale, while bringing about greater efficiency and savings in various costs, including energy and raw material costs. These plans include among others the anticipated savings from the expected transition to the use of natural gas at the Hadera plant, as described below.

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Concurrently, the Group is implementing the following cross-organization plans the Talent Management plan for the development of the Group's managers and the creation of managerial reserve, the WOW Program for enhancing the customers' perceived added value of the Company's products and improving loyalty premium and price based on differentiation of products and service, Kimberly Clark's global Centerlining program aimed at improving production lines (operating a methodology that creates a joint agenda for all elements impacting operations, including: engineering, maintenance, technology and operations, while constantly measuring the variation of selected parameters, thereby creating a process of constant improvement in quality and efficiency).

In addition, the Group raised the selling prices of its products, albeit only partially and not to the extent warranted by the increase in input prices due to the economic conditions outlined above, the more moderate slow down in demand and the escalating competition against both imports and local manufacturers.

These efficiency measures, together with the partial rise in prices, rendered it possible to significantly reduce the impact of the rising input prices on the results.

The Group is currently continuing its efforts to improve selling prices, on the one hand, while extending the efficiency measures on the other hand, in order to compensate for the said increased input prices.

It is impossible to estimate the impact of the above steps on the Group's profitability, at this stage.

A trend has been identified in early 2006 whereby the gap between supply and demand in the European paper market seems to be narrowing, given the economic growth in the EU. This trend is leading to announcements regarding increases paper prices in Europe and in the USA.

As part of the Company's endeavors to cut manufacturing costs and to achieve additional environmental improvements, the Company continues to promote the energy-generation plant project in Hadera, using natural gas.

The Company is initially preparing for the commencement of work on the conversion of its energy-generation systems from the use of fuel oil to natural gas, once the transportation infrastructure of natural gas to Hadera is completed. The transition is planned for the third quarter of 2007, subject to the arrival of the gas to Hadera.

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In this capacity, the Company signed an agreement in London on July 29, 2005, with the Thetis Sea Group, for the purchase of natural gas. The gas that will be purchased is intended to fulfill the Company's requirements in the coming years, for the operation of the existing energy co-generation plant at Hadera that will be converted for the use of natural gas, instead of the current use of fuel oil. The overall financial volume of the transaction totals \$40 million over the term of the agreement (5 years from the initial supply of gas, but no later than July 1, 2011).

The transition from fuel oil to natural gas will allow for significant savings, due to the significant differences between the current price of fuel oil versus the gas price and will serve to improve the Group's competitiveness and profitability.

The exchange rate of the NIS compared to the USD was devaluated by 6.8% during 2005, as compared with a revaluation of 1.6% in 2004.

The inflation rate during 2005 amounted to 2.4%, as compared with an inflation rate of 1.2% in 2004.

### III. Analysis of Operations and Profitability

The analysis set forth below is based on the consolidated data.

#### 1. Sales

The consolidated sales amounted to NIS 482.5 million in 2005, as compared with NIS 482.9 million in 2004.

The change in the turnover in 2005 originated from a certain growth in sales of packaging paper and paper waste, along with an insignificant decrease in the sales of office equipment sector due to the implementation of a reorganization process in this sector.

### III. Analysis of Operations and Profitability

2. Cost of Sales

The cost of sales amounted to NIS 383.2 million in 2005, representing 79.4% of sales, as compared with NIS 375.9 million, or 77.9% of sales in 2004.

The gross margin amounted to 20.6% in 2005, as compared with 22.1% in 2004.

The decrease in the gross margin originated primarily from the erosion of the gross profit due to the increase in raw material prices (approximately 9% for paper waste), the unusual rise in energy prices (approximately 38% for fuel oil and approximately 13% for electricity) and water (approximately 10%). This was partially offset by a certain quantitative growth in sales of packaging and paper waste, a certain rise in selling prices (that failed to compensate for the said rise) and the continuing efficiency measures across all areas of operation.

3. Labor Wages

The labor wages in the cost of sales, in selling expenses and in General and Administrative expenses, amounted to NIS 149.7 million in 2005, as compared with NIS 143.5 million in 2004.

The increase in wages is attributed to a certain rise in manpower due to the quantitative growth, coupled with the preservation of a real level of wages, in CPI terms.

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4. Selling, General and Administrative Expenses

The selling, general and administrative expenses (including wages) amounted to NIS 51.5 million in 2005, 10.7% of sales, as compared with NIS 53.0 million, 11.0% of sales, in 2004.

The decrease in selling and General and administrative expenses originated from continuing efficiency and cost-cutting measures.

5. Operating Profit

The operating profit amounted to NIS 47.8 million in 2005, representing 9.9% of sales, as compared with NIS 53.9 million, or 11.2% of sales in 2004.

The decrease in the operating profit in the paper and recycling sector in 2005 as compared with 2004 originated primarily from the said erosion of margins, due to the sharp rise in input prices (primarily energy, electricity and water) on the one hand, along with the difficulty in raising prices as warranted by the said rise in input prices due to competing imports.

The substantial decrease in the office supplies sector loss in 2005 as compared with 2004 resulted from the reorganization process implemented in this sector, along with extensive efficiency measures and operations in order to increase sales.

6. Financial Expenses

Financial expenses amounted to NIS 12.5 million in 2005, as compared with NIS 13.1 million in 2004.

The total average of the Company's net, interest-bearing liabilities grew by approximately NIS 58 million, as a comparison between 2005 and 2004. The growth originated primarily from the payment of NIS 100 million in dividends in September 2004 and NIS 50 million in September 2005, coupled with investments in fixed assets, net of dividend received from a consolidated subsidiary (NIS 21.8 million) and net of the positive cash flows from operating activities.

Moreover, the cost of the transaction for hedging the Series 2 notes against a rise in the CPI has risen to 1.3% per annum in 2005, as compared with 0.92% per annum in 2004 and resulted in an increase in costs related to the notes.

III. Analysis of Operations and Profitability

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Nevertheless, since the Consumer Price Index (CPI) rose by an actual 2.4% in 2005, the hedging transaction of 1.3% resulted in savings of NIS 2.7 million on additional financing costs on account of the CPI-linked notes.

Despite the aforesaid, the devaluation in 2005, that served to increase the financial revenues from the Company's dollar-denominated assets, as compared with the revaluation that took place in 2004, resulted in net financial expenses that were lower in 2005 than in 2004.

### 7. Taxes on Income

Expenses for taxes on income from current operations totaled NIS 10.2 million in 2005, as compared with NIS 13.2 million in 2004.

The principal factors responsible for the decrease in tax expenses in 2005 as compared with 2004 include the decrease in pre-tax earnings this year and the lower tax rate this year, in relation to last year.

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A tax benefit of NIS 4.2 million was recorded in 2005 on account of the impact of the tax reforms that were passed by the Knesset in July this year (gradually lowering the corporate tax rate to 25% by 2010) on the company's deferred taxes. The financial statements in 2004 included a tax benefit of NIS 5.8 million on account of the impact of the change in the corporate tax rate that was passed in 2004 on the company's deferred taxes, coupled with an additional tax benefit of NIS 4.2 million on account of the exercise of options by employees.

The tax expenses, including the said benefits, amounted to NIS 6.0 million in 2005, as compared with NIS 3.2 million in 2004.

### 8. Company's Share in Earnings (losses) of Associated Companies

The companies whose earnings are reported under this item (according to AIPM's holdings therein), primarily include: Mondi Hadera, Hogla-Kimberly, Carmel and T.M.M.

The Company's share in the earnings of associated companies (before non-recurring items) amounted to NIS 12.6 million in 2005, as compared with NIS 20.7 million in 2004.

The following principal changes were recorded in the Company's share in the (losses) earnings of associated companies, (before non-recurring items):

The Company's share in the net earnings of Mondi Hadera (49.9%) decreased by NIS 10.1 million in 2005, as compared with 2004 (2004 gain, 2005 loss). Most of the change in profit in 2005 as compared with 2004 originates from the decrease in operating income between the years, as a result of the rebuild that was carried out on the paper machine this year. The massive rebuild that was intended to improve the output of the machine and the quality of the paper, necessitated discontinuing the manufacturing process during the rebuild and was accompanied by a subsequent learning curve, as is normal during such a significant project. The unusual increase in raw material, energy and water prices also adversely affected the profitability of Mondi Hadera. The economic slowdown in Europe and the surplus of paper led to an erosion of imported paper prices and rendered it difficult for Mondi Hadera to raise prices, as warranted from the said price hikes both in local markets and especially in export markets. Mondi Hadera is nevertheless continuing with its efforts to raise prices (in parallel to announcing higher prices in Europe in late 2005) and is intensifying its efficiency and cost-cutting measures.

The Company's share in the net earnings of Hogla-Kimberly (49.9%) increased by NIS 2.9 million in 2005, as compared with 2004. The stronger marketing operations and the fortification of brands, in combination with the increase in prices and effective efficiency measures, served to compensate in 2005 for the sharp rise in input prices (raw materials and energy) and improved the operating income. Hogla-Kimberly continues to improve the quality of its products, while strengthening its brands, including Mollett Hearts toilet paper, Kotex hygiene products and Nikol (complementary kitchen products).

A net loss of NIS 3.5 million was recorded in the second quarter of 2005 on account of AIPM's share in a supplemental provision for doubtful debts, that was recorded by Hogla-Kimberly on account of the debts of Club Market, that is in a stay of proceedings and is currently subsequent to its acquisition by Supersol undergoing a settlement of debts. The settlement was approved by the court, but has yet to be finalized. The sum of the settlement is yet unknown.

The Company's share in the losses of Kimberly Clark Turkey, a wholly-owned Hogla-Kimberly subsidiary that is consolidated in its financial statements (hereinafter: KCTR, formerly Ovisan) (49.9%) has decreased by NIS 6.6 million in 2005, as compared with 2004. In 2005, KCTR has continued its preparation for the expansion of operations in the Turkish market and for the introduction of Kimberly Clark's international premium products into the Turkish market, as part of the multi-annual program (that is being formulated in conjunction with Kimberly Clark). In this capacity, the local management team was reinforced, to enable the realization of the said plan. KCTR has started the introduction of the Kotex® line of feminine hygiene products in late 2005 and is expected to introduce Huggies® diapers in 2006. KCTR recorded a significant loss in 2004, since the deployment of its distribution network on the one hand, and fierce competition in the Turkish market, on the other hand, resulted in the need to adjust the value of inventories to the prevailing market prices at the end of that year.

The Company's share in the net earnings of the Carmel Group (26.25%) decreased by NIS 2.8 million in 2005 as compared with 2004. The change in 2005 originated from a decrease in operating profit and a rise in financial expenses (due to devaluation differentials). The decrease in operating profit, despite the quantitative increase in sales, originated primarily from the sharp rise in raw material prices, that was only partially offset by the rise in selling prices (in view of the escalating competition in the corrugator market), leading to a consequent erosion in the gross margin. In 2005, Carmel began making investments as part of the strategic move to improve the corrugation base with the intention of rendering the manufacturing process more efficient. At the end of this process, the output capacity will reach 100 thousand tons. The investment will be completed in 2006.

The Company's share in the net earnings of T.M.M. (43.08%) decreased by NIS 4.6 million in 2005 as compared with 2004 (2004 gain, 2005 loss). T.M.M. recorded a sharp decrease in operating profit in 2005 as compared with 2004, due to the significant rise in transportation costs (originating from a significant average rise of 32% in diesel prices as compared with 2004 - an impact of NIS 8 million). This unusual increase in diesel prices was not sufficiently compensated for in the selling prices, due to the fact that most of the agreements are linked to the Consumer Price Index (CPI), that rose by only 2.4% this year. T.M.M. is intensively carrying out efficiency measures and is attempting to modify some of the agreements, so as to reflect the extraordinary increase in diesel prices.

We note that some of the customers began responding to the price changes in late 2005.

The Company's share in the earnings of associated companies in 2005 includes its share in the tax benefits recorded by these companies, following the change in tax rates (in the amount of NIS 3.9 million) amounts to NIS 16.4 million, as compared with NIS 25.1 million in 2004 (including a tax benefit of NIS 4.4 million).

## **B. Liquidity and capital resources**

### **1. Cash Flows**

The cash flows from operating activities in 2006 amounted to NIS 53.1 million, as compared with NIS 88.6 million in 2005. The change in the cash flows from operating activities in 2006 is primarily attributed to the increase in working capital, originating mostly from the growth in the volume of operations.

The cash flows from operating activities in 2004 amounted to NIS 47.1 million.

The dividend that was declared in December 2005, in the amount of NIS 50 million, was paid in January 2006. In addition, a dividend of NIS 100 million was paid in July 2006.

### **2. Financial Liabilities**

The Company believes that its existing credit lines and cash flow from operations are sufficient for financing its working capital needs. The Company uses its cash flow from operating activities to finance its investments and for repayment of loans and dividend distributions to its shareholders.

Based on the Company's balance sheet, the Company believes that it is unlikely that there will be any difficulties to obtain credit, whether short term debt or long-term debt, to finance anticipated investments.

On December 21, 2003, the Company issued notes through tender by private placement in the amount of NIS 200 million, to institutional investors. These notes carry an interest rate of 5.65% per annum (a margin of 1.45% above government notes with a comparable average maturity at the time). The principal will be repaid in seven equal annual installments between the years 2007-2013 (average maturity of 6 years), with both the principal and the interest being linked to the CPI. The notes are not convertible into the Company's ordinary shares and shall not be registered for trade on a public exchange.

The long-term liabilities (including current maturities) of the Companies amounted to NIS 297.9 million as at December 31, 2006 as compared with NIS 267.4 million as at December 31, 2005.

The Company uses loans from local financial institutions, mostly banks, to finance its activities. As of December 31, 2006, these loans consisted of the following:

1. Short-term credit from banks AIPM has a bank credit facility of some NIS 360 Million. Of this, as of December 31, 2006, some NIS 242 Million were utilized. The Company does not have any credit limitations (i.e. financial covenants) other than this. see Note 10c to the Financial Statements attached.
2. Notes see Note 4a to the Financial Statements attached.
3. Long Term Loans See Note 4b to the Financial Statements attached.
4. Other liabilities see Note 4c to the Financial Statements attached. For information regarding financial instruments used for hedging purposes and market risks see Item 11, Quantitative and Qualitative Disclosure about Market Risk.

The Group may incur additional tax liabilities in the event of inter-company dividend distributions, derived from approved enterprises profits. The said dividend distributions from investee companies is in the amount of up to approximately NIS 94 million (of which the Company's share of the additional tax is NIS 16 million, if this dividend is distributed). No account was taken of the additional tax, since AIPM has the ability and the intention that such earnings are to be reinvested and that no dividend would be declared which would involve additional tax liability to the Group in the foreseeable future.

### 3. Material commitments for Capital Expenditures

The Company also contracted with Alstom Power Boiler Service gmbh, a manufacturer of equipment in the energy industry, in an agreement worth approximately 1.74 million, for the purchase of the systems needed for the conversion and assistance with their installation at the plant in Hadera. Up to December 31, 2006 the remainder of the agreement was worth approximately 0.6 million.

### C. Research and development, patents and licenses, etc.

There were no significant investments in research and development activities during the last three years.

### D. Trend information

For trend information see The Business Environment section included in Item 5 above.

**E. Off Balance sheet Arrangements**

The Company does not have any material off balance sheet arrangements, as defined in Item 5E of Form 20-F.

**F. Contractual Obligations**

In NIS in million	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Long term debt obligations*	275.1	48.7	127.8	67.4	31.2
Purchase obligations**	158.6	13.7	123.5	21.4	

\* Including interest

\*\* From natural gas agreement

**ITEM 6 - DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. Directors and Senior Management**

The following table sets forth certain information with respect to the directors and executive officers of the Company:

<u>NAME</u>	<u>DIRECTOR SINCE</u>	<u>AGE</u>	<u>POSITION</u>
<b><u>Directors:</u></b>			
Ronit Blum	2005	55	Director
Nochi Dankner	2003	53	Director
Avi Fischer	2004	51	Director
Oren Lieder	2003	59	Director (until May 11, 2006)
Ari Bronshtein	2006	38	Director (from May 11, 2006) Chairman of the Board since April 02, 2006
Zvi Livnat	2003	54	Director
Amir Makov	2005	73	Director
Isaac Manor	2003	66	Director
Amos Mar-Haim	1984	69	Director
Adi Rozenfeld	2004	53	Director
Avi Yehezkel	2003	49	Director

The business experience of each of the directors is as follows:

*Ms. Ronit Blum* is Director of Association of Friends, Tel Aviv Sourasky Medical Center, engaged in the field of managing donations to the Medical Center.

*Mr. Ari Bronshtein* is Vice President of Discount Investments Corporation Ltd. Serves as director at various companies. Formerly served as Deputy CEO of Economics and Business Development of Bezeq, the Israeli Telecom Company Ltd.

*Mr. Nochi Dankner* is Chairman and Chief Executive Officer of IDB Holdings Corporation Ltd., Chairman of IDB Development Ltd., Discount Investments Corporation Ltd. and of Clal Industries and Investments Ltd. He serves or served as Chairman and Director in public and private companies of Ganden Group, IDB Group and Bank Hapoalim.



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*Mr. Avi Fischer* is Director and Co-CEO of Clal Industries and Investments Ltd. and Deputy Chairman of IDB Development Ltd, Deputy CEO of IDB Holdings Corporation Ltd., director of Discount Investment Corporation Ltd. and Chairman and director of several public and private companies of Ganden Group and IDB Group. Senior partner of Fischer, Behar, Chen & Co. Law Office.

*Mr. Zvi Livnat* is Chairman of the Board of the Company since April 2006, Co-CEO of Clal Industries and Investments Ltd., Executive Vice President of IDB Holding Corporation Ltd., Deputy Chairman of IDB Development Corporation Ltd., director in Discount Investments Corporation Ltd., and other public and private companies.

*Mr. Amir Makov* is the Chairman of The Israel Institute of Petroleum & Energy and the Israel Export & International Cooperation Institute, Chairman of Polyon Plastic Industries Ltd, a member of the presidency of the Manufacturers Association of Israel, and a director in the following companies: ICL Fertilizers (Dead Sea Works, Rotem Amfert Negev), ICL Industry Products (Dead Sea Bromine Company, Dead Sea Periclase), and an external director in Wolfman Industries. Mr. Makov served as an external director of the Company between 1996-2001.

*Mr. Isaac Manor* is a Deputy Chairman of IDB Holdings Corporation Ltd., IDB Development Ltd., Discount Investments Corporation Ltd. and of Clal Industries and Investments Ltd and a director of various publicly-traded and privately-held companies within the IDB Group, IDB Holdings Ltd., IDB Development Ltd., Discount Investment Corporation Ltd. and Clal Industries and Investments Ltd, Israel Union Bank Ltd. and others and Co-CEO and Chairman of companies in the David Lubinsky Group Ltd.

*Mr. Amos Mar-Haim* is a member of the Israel Accounting Standards Board and a director of various companies; Deputy Chairman of Phoenix Investments & Finances Ltd, Chairman of Migdal underwriting & Promotion of Investments Ltd.

*Mr. Adi Rozenfeld* is a businessman, consultant to companies and a representative of Activa Holdings BV in Israel. He is also the Honorary Consul of Slovenia in Israel and a director of various companies. Chairman of Association of Friends, Haifa University.

*Mr. Avi Yehezkel* is an external director at Bank Yahav. He served as a Knesset member between 1992-2003, during these years, alternately, he served as Deputy Minister of transportation, Chairman of the Economics Committee, Chairman of the Defense Budget Committee, Chairman of the Capital Market Sub-Committee, Chairman of the Banking Sub-Committee and member of the Finance Committee.

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### Senior Management in the Company and in Subsidiaries (as of May 28, 2007)

<u>Name</u>	<u>Age</u>	<u>Position</u>
Avi Brener	54	Chief Executive Officer
Israel Eldar	62	Corporate Controller and responsible for risks and business interruption management.
Ofra Gorni	54	Business Development Manager.
Lea Katz	56	Legal counsel and Corporate Secretary .
Gabi Kenan	63	Senior Manager
Gur Ben David	55	General manager of Packaging Paper and Recycling Division (as of January 01, 2007).
Pinhas Rimon	67	General manager of Packaging Paper and Recycling Division (until December 31, 2006).
Gideon Liberman	57	A director of subsidiaries and affiliated companies of the Company.
Amir Moshe	41	General Manager of Development and Infrastructure Division
Moshe Riani	48	General Manager, Graffiti Office Supplies & Paper Marketing Ltd. (as of January 01, 2007).
Uzi Carmi	51	General Manager, Graffiti Office Supplies & Paper Marketing Ltd. (until December 31, 2006).
Simcha Kenigsbuch	49	General Manager, Amnir Recycling Industries Ltd.
		Chief Information Officer

### Senior Management in Affiliated Companies (as of May 28, 2007)

<u>Name</u>	<u>Age</u>	<u>Position in the Company</u>
Arik Schor	51	General Manager, Hogla-Kimberly Ltd.
Avner Solel	53	General Manager, Mondi Business Paper Hadera Ltd.
Doron Kempler	57	General Manager, Carmel Container Systems Ltd.

**B. Compensation**

The aggregate amount of remuneration paid to all directors and the above senior officers of the Company (23 officers and directors) as a group for services provided by them to the Company during 2006 was approximately NIS 19,380,980 (approximately \$4,587,214). The aggregate amount set aside for pension, retirement or similar benefits for directors and officers as a group for services provided by them to the Company during 2006 was approximately NIS 1,561,006 (approximately \$369,469).

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The aggregate amount of remuneration paid to all directors and senior officers of the Company mentioned above, include payments paid by the Corporation and liabilities to pay taken by it, to the 5 senior officers, as follows<sup>(1)</sup>:

	<b>Position</b>	<b>Thousands NIS</b>
No' 1	Chairman of the Board of Directors (until 04/06) <sup>(2)</sup>	5,692
No' 2	CEO <sup>(3)</sup>	2,402
No' 3	Division Manger	1,448
No' 4	Vice President	1,348
No' 5	Division Manger	1,112

In addition, the senior officers of the Company and of certain other companies in the Group, were granted a stock option plan. For stock option plan granted to senior officers, see Item 6.E. Share ownership below, and Note 6b of the Notes to the Consolidated Financial Statements.

**Remuneration of Directors**

The remuneration of the directors (including the external directors) for 2006 was approved at the 2006 general meeting of shareholders. Pursuant to regulations under the Israeli Companies Law, each external director of the Company must receive the same annual compensation, which must be between NIS 29,010 and NIS 47,135, plus an additional fee for each meeting attended which must be between NIS 1,021 and NIS 1,813. The Board approved that the remuneration of each director for the year 2006, including the external directors, be fixed at NIS 40,000 plus an additional NIS 1,550 for each meeting attended.

- (1) The following, details remuneration payments paid by the Company and liabilities to pay taken by it, to the 5 senior officers of the Company, as reported by the Company at the Periodical Report published, in March 2007, following the Company's obligation to present that information, according to the Israeli Law.
- (2) The Chairman of the Board of Directors retired on April 2, 2006, from his position as Chairman of the Board of Directors after 37 years of employment in senior positions in the Group. The above mentioned sum of money includes its payment fees for 3 months and remuneration for execution of the remnant of remuneration according to the incentive plan approved at the General meeting on May 2001.

In addition, the Company paid on April 2007 the retired Chairman, according to the agreement with him that was approved by the Board of Directors in March 2003 and at the General meeting in July 2003, an amount of NIS 4.992 million, and an additional amount paid in April 2007 to providence fund to cover gaps in deposits for previous years to the retired Chairman.

- (3) On May 13, 2007, the Board of Directors approved the Employment Agreement and remuneration of Mr. Avi Brener, the CEO of the Company. The main principals of the Agreement are: monthly salary of NIS 95,000 (approximately \$22,864) linked to the Israeli Consumer Price Index and a yearly bonus in the amount of between 6-9 salaries, subject to the discretion of the Board. In addition, upon

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the termination of employment of the CEO he will receive, in addition to the provisions for severance payments, a retirement grant payment in an aggregate amount equal to one-month's salary for each year in which he was employed by the Group (from August 1988).

**C. Board practices**

The directors of the Company, except for the external directors (see below), retire from office at the Annual General Meeting of Shareholders and are eligible for re-appointment at such Annual General Meeting.

Notwithstanding the foregoing, if no directors were appointed at any Annual General Meeting, the directors appointed at the previous Annual General Meeting will continue in office. Directors, except for the external directors, may be removed from office earlier by a resolution at an Annual General Meeting of Shareholders.

The Articles of Association of the Company provide that any director may, by written notice, appoint any person who is approved by the Board of Directors to be an alternate director and to act in his place and to vote at any meeting at which he is not personally present. The alternate director is entitled to notice of Board meetings and he will be remunerated out of the remuneration of the director appointing him. The alternate director shall vacate his office if and when the director appointing him vacates his office as director, or removes him from office by written notice.

There are no services contracts which give the current directors of the Company any benefits upon termination of office.

**External Directors**

Under the Israeli Companies Law, the Company (as a public company) is required to have at least two external directors as members of its Board of Directors. An external director may not have any financial or other substantial connection with the Company and must be appointed at the Annual General Meeting of Shareholders. The external directors are elected for a three-year term of office that may be extended for another three years. Currently the external directors are Ms. Blum and Mr. Makov.

For the periods each director served in his or her respective position, see Item 6.A. Directors and Senior Management above.

For a description of the Termination and Employment Agreement of the Company's former Chairman of the Board, see Item 6.B. Compensation above. Aside from Mr. Yerushalmi, none of the Group's directors are entitled to benefits upon termination of their employment.

**Audit Committee**

Under the Israeli Companies Law, members of the Audit Committee are to be elected from members of the Board of the Company by the Board. The Audit Committee will be comprised of at least three directors, including all of the external directors, but excluding: (i) the Chairman of the Board of Directors; (ii) any director employed by the Company or who provides services to the Company on a regular basis; or (iii) a controlling shareholder of the Company or his relative.

The role of the Audit Committee under the Israeli law is: (i) to examine flaws in the business management of the Company in consultation with its auditors and to suggest appropriate courses of action and (ii) to decide whether to approve actions or transactions which under the Israeli Companies Law require the approval of the Audit Committee (transaction with a related party, etc.) The Company does not have a Nominating Committee nor a Compensation Committee.

The role of the Audit Committee under the American law is: (i) to oversee on behalf of the Board: (a) the integrity of the financial statements; (b) the appointment, compensation, qualification and work of the Independent Auditors; (c) compliance with legal and regulatory requirements applicable to the internal controls and reporting of publicly traded companies; (d) performance of Internal Auditor and internal controls functions; and (ii) to evaluate potential or existing deficiencies in the administration, by consulting with the management, and make proposal to the Board; and (iii) to review matters referred to them under the Whistleblower process of the Company's Code of Conduct and Ethics.

The Company's Audit Committee members are: Amos Mar-Haim, Chairman, Ronit Blum, and Amir Makov. All members are independent directors, as that term is defined in the American Stock Exchange listing standards.

**D. Employees**

As of April 30, 2007, the Group had 2,950 employees in Israel, of which the Company and its subsidiaries had 798 employees in Israel of whom 158 were engaged in the office supplies activities, 622 in packaging paper and recycling division, and 18 were management and clerical personnel at the Company's headquarters in Hadera. The associated companies had 2,152 employees in Israel of whom 1,037 were engaged in the household paper activities (in addition, KCTR had 240 employees), 321 in the printing and writing paper activities and 794 in the corrugated board containers activities.

Some of the employees are subject to the terms of employment of collective bargaining agreements. The parties to such collective bargaining agreements are the Company and the employees, through the union. The relationship between the Company and the union is good and based on continuous dialogue.

**E. Share ownership**

In April 2001, the Board of Directors of the Company adopted a new stock option plan under which options to purchase a total of 194,300 shares may be granted to senior officers of the Company and certain other companies in the Group. All of the options were granted by July 2001. Each option is exercisable to purchase one ordinary share of NIS 0.01 par value of the Company. The options vest in four yearly installments. The vesting period of the first installment is two years, commencing on the date of grant, and the next three installments vest on the third, fourth and fifth anniversary of the grant date. Each installment is exercisable for two years from the vesting date of such installment. For further information regarding the 2001 plan, see Note 6 of the Notes to the Consolidated Financial Statements.

In 2006, 44,998 options were exercised under the 2001 plan and 24,303 shares were issued following the exercise of options.

In August 2001, the Company's Board of Directors approved a stock option plan for employees of the Company and its subsidiaries, that expired on November 3, 2006. Under this plan, up to 125,000 options may be granted without consideration. Each option is exercisable to purchase one ordinary share of NIS 0.01 par value of the Company. In November 2001, 81,455 options were granted under the 2001 employee plan. The vesting period of the options is two years from the date of grant. Each option is exercisable within three years from the end of the blocking period. For further information regarding the 2001 employee plan, see Note 6 of the Notes to the Consolidated Financial Statements.

In 2006, 10,091 options were exercised under the 2001 employee plan and 6,215 shares were issued following the exercise of options. The employees' option plan expired on November 3, 2006.

**ITEM 7 MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS****A. Major shareholders**

The following table sets forth, as of May 28, 2007, the number of Ordinary Shares of the Company beneficially owned by (i) all those persons who, to the Company's knowledge, were the beneficial owners of more than 5% of such outstanding shares, and (ii) all officers and directors of the Company as a group:

<b>Name and Address: Principal Shareholders:</b>	<b>Amount Beneficially Owned Directly or Indirectly*</b>	<b>Percent of Class Outstanding</b>
Clal Industries Ltd. ("Clal") 3 Azrieli Center, the Triangle Tower, Tel Aviv, Israel	1,531,128 <sup>(1)</sup>	37.83 <sup>(1)</sup>
Discount Investments Corporation Ltd. ("DIC") 3 Azrieli Center, the Triangle Tower, Tel Aviv, Israel	865,014 <sup>(1)</sup>	21.37 <sup>(1)</sup>
All officers and directors as a group	**	**

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In 1980 DIC and Clal agreed for a period of ten years (subject to renewal for additional ten year periods) to coordinate and pool their voting power in the Company in order to appoint an equal number of each party's nominees to the Board of Directors of the Company, and in order to elect their designees to the Board's Committees. They also agreed to vote as bloc in General Meetings of the Company on the subject of dividend distributions. This agreement has been extended to the year 2010.

- \* Beneficial ownership is calculated in accordance with Rule 13d-3 under the Securities Exchange Act of 1934.
- \*\* The officers and directors of the Company own, in the aggregate, less than 1% of the Company's outstanding ordinary shares, except for Nochi Dankner, Isaac Manor and Zvi Livnat whose ownership is set forth in footnote (1) below.
- (1) IDB Holding Corporation Ltd. ( IDBH ) holds 72.4% of the equity of and 72.69% of the voting power in IDB Development Corporation Ltd. ( IDBD ), which, in turn, holds 74.76% of the equity of and voting power in DIC and 60.52% of the equity of and voting power in Clal. IDBH, IDBD, Clal and DIC are public companies traded on the Tel Aviv Stock Exchange.

Since May 19, 2003 approximately 51.7% of the outstanding share capital of IDBH, is held by a group comprised of: (i) Ganden Investments I.D.B. Ltd. ( Ganden ), a private Israeli company controlled by Nochi Dankner and his sister, Shelly Bergman, which holds approximately 31.02% of the outstanding shares of IDBH; (ii) Manor Investments-IDB Ltd. ( Manor ), a private Israeli company controlled by Isaac and Ruth Manor which holds approximately 10.34% of the outstanding shares of IDBH; and (iii) Avraham Livnat Investments (2002) Ltd. ( Livnat ), a private Israeli company controlled by Avraham Livnat and Zvi Livnat which holds approximately 10.34% of the outstanding shares of IDBH. Ganden, Manor and Livnat, owning in the aggregate approximately 51.7% of the outstanding shares of IDBH, entered into a Shareholders Agreement relating, among other things, to their joint control of IDBH, the term of which is until May 19, 2023.

In addition: (a) Ganden Holdings Ltd., the parent company of Ganden, directly holds approximately 7.15% of the outstanding shares of IDBH and Ganden directly holds approximately 6.71% of the outstanding shares of IDBH; (b) Manor Holdings B.A. Ltd., the parent company of Manor, directly holds approximately 0.03% of the outstanding shares of IDBH; (c) Avraham Livnat Ltd., the parent company of Livnat, directly holds approximately 0.04% of the outstanding shares of IDBH; and (d) Shelly Bergman owns, through a private company wholly owned by her, approximately 7.23% of the outstanding shares of IDBH (hereinafter jointly: additional holdings ). It should be noted, that the additional holdings, are not included in the shareholders agreement between Ganden, Manor and Livnat, relating, among other things, to their joint control of IDBH.

Nochi Dankner is Chairman and CEO of IDBH and chairman of IDBD, Clal and DIC., Isaac Manor (the husband of Ruth Manor), and Zvi Livnat (the son of Avraham Livnat) are directors of each of IDBH, IDBD, and DIC . Isaac Manor is also director of Clal.

Since May 23, 2005, beneficial ownership percentages for Clal and DIC increased by 5.14% and 2.9%, respectively, as compared to the percentages as indicated in the chart above.

The Company estimates that as of May 30, 2007, 10.56 % of its outstanding ordinary shares were held in the United States by 851 record holders.

All ordinary shares of the Company have equal voting rights. The Company's major shareholders who beneficially own 5% or more of the Company's ordinary shares outstanding do not have a voting rights different from other holders of ordinary shares.

**B. Related Party Transactions**

The information is included in the Company's attached Consolidated Financial Statements. For loans to associated companies see Note 2 to the attached financial statements. For a capital note to an associated company, see Note 4c to the attached financial statements. For transactions and balances with related parties see Note 13 to the attached Financial Statements.

For further information see also Note 9e and 9d to the Financial Statements attached.

**C. Interests of Experts and Counsel**

Not applicable to annual reports.

**ITEM 8 - FINANCIAL INFORMATION**

**A. Consolidated Statements and Other Financial Information**

See the financial statements included in Item 17.

**B. Export Sales**

The amount of export sales represents approximately 9% out of the total sales volume of the Company.

**C. Legal Proceedings**

In September 2006, a petition was filed against H-K, an affiliated company (49.9%), for approval of a class action. According to the petition H-K has reduced the number of units of diapers in a package of its Titulim® brand and thus misled the public according to the Israeli Consumer Protection Act. The plaintiff estimated the scope of the class action to be NIS 47 million. On June 18, 2007, court approved plaintiff's abandonment from the petition for the approval of a class action, and also ordered the dismissal of the plaintiff's personal action, with no expenses order.

In December 2006, a petition was filed against H-K, an affiliated company (49.9%), for the approval of a class action. According to the petition, 3.5 years ago, H-K has reduced the quantity of paper in the toilet packages of its Kleenex® Premium brand and thus misled the public according to the Israeli Consumer Protection Act. The plaintiff estimates the scope of the class action to be approximately NIS 43 million. On June 26, 2007, the court approved plaintiff's abandonment from the petition for the approval of a class action, a payment of expenses to the plaintiff in the amount of NIS 10,000 and also ordered the dismissal of the plaintiff's personal action, with no expenses order.

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In January 2007, a petition was filed against H-K, an affiliated company (49.9%), for the approval of a class action. According to the petition, 3.5 years ago H-K reduced the quantity of wipes in the baby wipes packages of its Titulim® Premium brand and thus misled the public according to the Israeli Consumer Protection Act. The plaintiff estimated the scope of the class action to be approximately NIS 28 million. H-K rejects the claims and intends to defend itself against the action. At this early stage H-K is not able to assess the chances of the class action and its influences.

In November 2006, the Environmental Protection Ministry announced that even though the Company plant at Hadera has made considerable investments in sewage treatment and environmental protection issues, an investigation against the Company is required in connection with its plant at Hadera to review deviations from certain emission standards concerning air. The company anticipates that the investigation will not materially impact its operations.

On March 7, 2006, T.M.M., an associated company announced that the Israeli Securities Authority had addressed T.M.M. with regard to an investigation the authority is conducting. At this stage, T.M.M. is unable to estimate the impact of this investigation on the company. On February 04, 2007, the Company sold all its holdings in T.M.M.

### D. Dividend Policy

During 2006, the Company did not have a defined policy for distributing dividends.

### E. Significant Changes

On January 4, 2007, the Company entered into an Agreement with CGEA, according to which, the Company sold to CGEA its holdings in Barthelemi, and the rest of its holdings in T.M.M. for the total amount of \$ 27 million. This transaction was consummated on February 13, 2007, from which date the Company is no longer a shareholder in T.M.M.

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## ITEM 9 THE OFFER AND LISTING

### A. Offer and Listing Details

The following table sets forth the high and low market prices of the Company's ordinary shares on the American Stock Exchange and the Tel Aviv Stock Exchange for the five most recent full fiscal years:

	American Stock Exchange		Tel Aviv Stock Exchange			
	High	Low	High	Low	High	Low
	\$		NIS		\$( <sup>1</sup> )	

#### Calendar Year

2006	52.12	38.50	237.00	168.50	53.01	38.42
2005	57.98	37.50	246.90	176.90	56.42	38.24
2004	60.73	48.75	267.10	217.60	60.33	48.72
2003	54.66	29.22	239.00	143.60	54.58	30.01
2002	40.50	25.18	178.00	116.10	40.10	24.90

The following table sets forth the high and low market prices of the Company's ordinary shares on the American Stock Exchange and the Tel Aviv Stock Exchange for each fiscal quarter for the two most recent fiscal years and the first quarter of 2007:

	American Stock Exchange		Tel Aviv Stock Exchange			
	High	Low	High	Low	High	Low
2007 Quarter Ended						

### A. Offer and Listing Details



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	American Stock Exchange		Tel Aviv Stock Exchange			
	\$		NIS		\$ <sup>(1)</sup>	
June 30 (through June 25)	61.46	56.30	258.40	236.50	62.71	55.63
March 31	49.84	41.90	207.50	185.00	49.61	43.65
<b>2006 Quarter Ended</b>	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
	\$		NIS		\$ <sup>(1)</sup>	
March 31	49.23	42.00	227.00	197.50	49.60	42.26
June 30	52.12	41.52	237.00	194.00	53.01	43.17
September 30	46.67	38.50	228.80	168.50	51.78	38.42
December 31	48.55	41.00	206.00	177.10	47.63	41.24

(1) Share prices have been converted from New Israeli Shekels (NIS) to U.S. Dollars at the representative rate of exchange, as reported by the Bank of Israel, on the dates when such high or low prices in NIS were recorded.

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2005 Quarter Ended	High		Low		High		Low	
	\$		NIS		\$ <sup>(1)</sup>			
March 31	57.98	48.25	246.90	214.80	56.42	49.42		
June 30	52.00	42.13	227.60	187.50	52.21	41.30		
September 30	45.73	40.50	207.90	183.80	45.60	40.56		
December 31	44.00	37.50	200.20	176.90	43.61	38.24		

The following table sets forth the high and low market prices of the Company's ordinary shares on the American Stock Exchange and the Tel Aviv Stock Exchange for each month of the most recent six months:

	American Stock Exchange		Tel Aviv Stock Exchange			
	\$		NIS		\$ <sup>(1)</sup>	
May 2007	67.50	55.81	259.40	230.00	65.60	57.51
April 2007	56.75	47.21	230.80	198.70	56.62	47.82
March 2007	48.00	45.04	199.00	187.40	47.72	44.52
February 2007	49.84	43.82	207.50	188.10	49.61	44.38
January 2007	45.76	41.90	191.10	185.00	45.64	43.65

(1) Share prices have been converted from New Israeli Shekels (NIS) to U.S. Dollars at the representative rate of exchange, as reported by the Bank of Israel, on the dates when such high or low prices in NIS were recorded.

**B. Markets**

The Company's ordinary shares are listed on the American Stock Exchange. The trading symbol for the ordinary shares is AIP. The ordinary shares are also listed on the Tel Aviv Stock Exchange.

**ITEM 10 ADDITIONAL INFORMATION**

**A. Share Capital**

Not applicable to Annual Reports.

**B. Memorandum and Articles of Association**

The Company was registered under Israeli law on February 10, 1951 and its registration number with the Israeli registrar of companies is 52-001838-3.

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The Memorandum of Association and Articles of Association are attached as Exhibits 1.1 and 1.2 to this Annual Report.

**Objects of the Company**

As indicated in Article 5 of the Company's Articles, the Company may, at any time, engage in any branch or kind of business in which it is, expressly or by implication, authorized to engage in accordance with the Articles. The Company may also cease to engage in such businesses, whether or not it has commenced to engage in such branch or kind of business.

**Director's Personal Interest**

The Israeli Companies Law requires that a director and an officer of a company disclose to the Company any personal interest that he may have and all related material information, in connection with any existing or proposed transaction by the Company. The disclosure is required to be made promptly and in any event no later than the date of meeting of the board of directors in which the transaction is first discussed.

If the transaction is an extraordinary transaction, the procedure of approval is as described below. Under Israeli law, an extraordinary transaction is a transaction other than in the ordinary course of business, otherwise than on market terms or that is likely to have a material impact on the Company's profitability, assets or liabilities.

Subject to the restrictions of the Israeli Companies Law, a director is entitled to participate in the deliberations and vote with regard to the approval of transactions in which he has a personal interest. A director is not entitled to participate and vote with regard to the approval of an extraordinary transaction in which he has a personal interest, the approval of indemnity, exemption or insurance of the directors or the approval of the directors' compensation. If a majority of the directors have a personal interest in a certain decision, they may participate and vote but the issue must be approved also by the audit committee and by the shareholders. If the controlling shareholder has a personal interest in an extraordinary transaction, the issue must be approved also by the audit committee and the shareholders.

Any power of the Company which has not been conferred by law or by the Articles to any other body, may be exercised by the Board. The management of the Company is guided by the Board.

**Powers and Function of Directors**

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The Board shall formulate the policies of the Company and shall supervise the performance of the office and actions of the General Manager, including inter alia examination of the financial position of the Company and determination of the credit framework which the Company may receive. Without derogating from any power vested in the Board in accordance with the Articles, the Board may, from time to time, at its discretion, decide upon the issuance of a series of debentures, including capital notes or undertakings, including debentures, capital notes or undertakings which can be converted into shares, and also the terms thereof, and mortgage of the property of the Company, in whole or in part, at present or in future, by floating or fixed charge. Debentures, capital notes, undertakings or other securities, as aforesaid, may be issued either at a discount or at a premium or in any other manner, whether with deferred rights or special rights and/or preferred rights and/or other rights, all the aforesaid as the Board may, at its discretion, determine. Compensation to directors is subordinate to an approval of the Audit committee, the Board of Directors and the General meeting of the Shareholders. There are no provisions in the Company's Articles for the retirement of directors under an age limit.

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Except for special cases as detailed in the Articles and subject to the provisions of the Israeli Companies Law, the Board may delegate its powers to the General Manager, to an officer of the Company or to any other person or to the Board committees. Delegation of the powers of the Board may be with regard to a specific matter or for a particular period, at the discretion of the Board.

The directors need not be shareholders of the Company in order to qualify as directors.

### The Shares Rights and Restrictions

All of the Company's shares are ordinary shares. Every ordinary share in the capital of the Company is of equal rights, for all intents and purposes, to every other ordinary share, including the right to dividends, to bonus shares and to participation in the surplus assets of the Company upon liquidation, proportionately to the par value of each share, without taking into consideration any premium paid in respect thereof, all the aforesaid subject to the provisions of the Articles.

Each of the ordinary shares entitles the holder thereof to participate at and to one vote at Annual General Meetings of the Company. As described in Item 6C, all directors, except external directors, stand for election each year at the Annual General Meeting.

Subject to the provisions of the Israeli Companies Law, the Board may resolve upon the distribution of a dividend. When deciding on the distribution of a dividend, the Board may decide that the dividend shall be paid, in whole or in part, in cash or by way of the distribution of assets in specie, including securities or bonus shares, or in any other manner at the discretion of the Board.

Dividends on the Company's ordinary shares may be paid only out of retained earnings, as defined in the Israeli Companies Law, as of the end of the most recent fiscal year or profits accrued over a period of two years, whichever is higher.

The Company may, by resolution adopted at an Annual General Meeting by an ordinary majority, decrease the capital of the Company and of any reserve fund from redemption of capital. For the execution of any resolution as aforesaid, the Board may, at its discretion, resolve any issues, which may arise in connection therewith.

In case of winding up of the Company, the liquidator may determine the proper value of the assets available for distribution and determine how the distribution among the shareholders will be carried out.

The liability of the shareholders is limited to the payment of par value of their ordinary shares.

Under the Israeli Companies Law, each shareholder has a duty to act in good faith in exercising his rights and fulfilling his obligations toward the Company and other shareholders and to refrain from abusing his power in the Company.

In addition, each shareholder has the general duty to refrain from depriving other shareholders of their rights.

Furthermore, any controlling shareholder, who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the Articles, has the power to appoint or to prevent the appointment of an officer in the Company or any other power toward the Company is under a duty to act in fairness toward the Company. The Israeli Companies Law does not describe the substance of this duty of fairness. These various shareholder duties may restrict the ability of a shareholder to act in what the shareholder perceives to be its own best interests.

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### Modification of Rights of Shares

If the share capital is divided into different classes, the Company may by resolution adopted at a General Meeting by a special majority of 60% of the votes of shareholders (in person or by proxy) voting at the General Meeting (except if the terms of the issuance of the shares of such class otherwise provide) annul, convert, expand, supplement, restrict, amend or otherwise modify the rights of a class of shares of the Company, provided that the consent, in writing, of all the shareholders of such class thereto shall be received or that the resolution shall have been approved by a General Meeting of the shareholders of such class by special majority, or in the event that it was otherwise provided in the terms of the issuance of a particular class of the shares of the Company, as may have been provided in the terms of issuance of such class, provided that the quorum at the class meeting shall be the presence, in person or by proxy, at the opening of the meeting of at least two shareholders who own at least twenty five percent (25%) of the number of the issued shares of such class.

The rights conferred upon the shareholders or owners of a class of shares, whether issued with ordinary rights or with preference rights or with other special rights, shall not be deemed to have been converted, restricted, prejudiced or altered in any other manner by the creation or issuance of additional shares of any class, whether of the same degree or in a degree different or preferable to them, nor shall they be deemed to have been converted, restricted, prejudiced or altered in any other manner by a change of the rights linked to any other class of shares, all the aforesaid unless otherwise expressly provided in the terms of the issuance of such shares.

### Shareholders Meeting

The Company shall hold an Annual General Meeting each year not later than fifteen months after the previous Annual Meeting, at such time and place as may be determined by the Board. Any other General Meeting is referred to as a Special Meeting.

A notice of a General Meeting shall be published in at least two widely distributed daily newspapers published in Hebrew. The notice shall be published at least twenty-one days prior to the convocation of the meeting. In addition the Company provides a notice of the meeting and related proxy statement in English to the holders of its Ordinary Shares listed on the records of the Company's registrar and stock transfer agent in the United States.

Apart from the notices as to the General Meeting as above, according to its articles and the Israeli Companies Law the Company is not required to give any notice as to the General Meeting, either to the registered shareholders or to shareholders who are not registered, subject to provisions of the Companies Law and/or any other applicable law. The notice as to a General Meeting is required to detail the place, the day and the hour at which the meeting will be held and to include the agenda as well as a summary of the proposed resolutions and any other details required by law.

The Board of Directors of the Company shall convene a Special Meeting as may be decided by the Board, and shall also convene a special meeting at the demand of any two directors or one quarter of the directors in office or one or more shareholders who hold at least five percent of the issued capital and one percent of the voting rights, or one or more shareholders who hold at least five percent of the voting rights.

If the Board receives a demand for the convocation of a Special Meeting as aforesaid, the Board shall within twenty one days of receipt of the demand convene the meeting for a date fixed in the notice as to the Special Meeting, provided that the date for convocation shall not be later than thirty five days from the date of publication of the notice, all the aforesaid subject to the provisions of the Companies Law.

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In the resolution of the Board to convene a meeting, the Board may, at its discretion and subject to the provisions of the law, fix the manner in which the items on the agenda will be determined and notice given to the shareholders entitled to participate at the meeting.

Each shareholder holding at least ten percent (10%) of the issued capital and one percent (1%) of the voting rights, or each shareholder holding at least ten percent (10%) of the voting rights is entitled to request the Board to include in the agenda any issue, provided that this issue is suitable to be discussed in a General Meeting.

No business shall be transacted at any General Meeting unless a quorum is present at the time the meeting proceeds to business. A quorum shall be constituted when two shareholders, holding collectively at least twenty five percent (25%) of the voting rights, are present in person or by proxy within half an hour from the time appointed for commencement of the meeting, unless otherwise determined in the Articles.

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If a quorum is not present within half an hour, the meeting shall stand adjourned for seven days, to the same day of the week at the same time and place, without need for notification to the shareholders, or to such other day, time and place as the Board may by notice to the shareholders appoint.

If a quorum is not present as aforesaid at the adjourned meeting, the meeting shall be canceled.

### Voting and Adopting Resolutions at General Meetings

A shareholder who wishes to vote at a General Meeting shall prove to the Company his ownership of his shares. The Board may issue directives and procedures relating to the proof of ownership of shares of the Company.

A shareholder is entitled to vote at a General Meeting or class meeting, in person, or by proxy or by proxy card. A voting proxy need not be a shareholder of the Company.

The above shall also apply to any person entitled to shares, provided that at least forty eight hours before the time for the meeting or the adjourned meeting, as the case may be, at which he proposes to vote, he shall satisfy the Board of his right to vote such shares unless the Company shall have previously recognized his right to vote the shares at such meeting.

The instrument appointing a proxy (hereinafter Proxy Appointment ) shall be in writing signed by the principal, or if the principal is a corporation the proxy appointment shall be in writing and signed by authorized signatories of the corporation. The Board is entitled to demand that prior to the holding of the meeting, there shall be produced to the Company a confirmation in writing of the authority of signatories to bind the corporation to the satisfaction of the Board. The Board may also issue provisions and procedures relating to such matters.

The Proxy Appointment or an office copy to the satisfaction of the Board shall be deposited at the registered office or at such other place or places, in or outside of Israel, as may from time to time be determined by the Board, either generally or in respect of a specific meeting, at least forty eight hours prior to the commencement of the meeting or the adjourned meeting, as the case may be, at which the proxy proposes to vote on the strength of such Proxy Appointment.

A voting proxy is entitled to participate in the proceedings at the General Meeting and to be elected as chairman of the meeting in the same manner as the appointing shareholder, unless the Proxy Appointment otherwise provides. The Proxy Appointment shall be in form usual in Israel or any other form which may be approved by the Board.

According to an amendment in the Israeli Companies Law , a shareholder is also entitled, in certain issues, to vote by a proxy card.

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Each ordinary share entitles the holder thereof to participate at a General Meeting of the Company and to one vote at a poll.

### Right of Non-Israeli Shareholders to Vote

There is no limitation on the right of non-resident or foreign owners of any class of the Company's securities to hold or to vote according to the rights vested in such securities.

### Change of Control

Under the Articles, the approval of merger as provided in the Israeli Companies Law, is subject to a simple majority at the General Meeting or class meeting, as the case may be, all the aforesaid subject to the applicable provisions of any law. It is also subject to the approval of the boards of the merging companies.

For purposes of shareholders' approval, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares held by shareholders voting at the general meeting, other than the shareholders who are also shareholders in the other merging company whose shares are held by the other merging company, or by any person who holds 25% or more of the shares or the right to appoint 25% or more of the directors in the other merging company, vote against the merger. Upon the request of a creditor of either party to the proposed merger, a court

may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least 30 days have passed from the date that the merger was approved at the general meeting of all the merging companies and at least 50 days have passed from the time that a proposal of the merger has been filed with the Israeli Registrar of companies.

The Israeli Companies Law also provides that an acquisition of shares of a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% shareholder of the Company and there is no existing 25% or more shareholder in the Company. If there is no existing 45% or greater shareholder in the Company, the Companies Law provides that an acquisition of shares of a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% shareholder of the Company.

If following any acquisition of shares, the acquirer will hold 90% or more of the Company's shares, the acquisition may not be made other than through a tender offer to acquire all of the shares of such class. If more than 95% of the outstanding shares are tendered in the tender offer, all the shares that the acquirer offered to purchase will be sold to it. However, the remaining minority shareholders may seek to alter the consideration by court order.

Under the Israeli Securities Act 1968, any major shareholder who is the beneficial owner of more than 5% of the Company's equity capital or voting securities is required to report this fact and any change in his holding to the Israeli Securities Authority.

### C. Material Contracts

In May 2007, the Company entered into an agreement with East Mediterranean Gas Company (EMG) for the purchase of natural gas from Egypt. The Agreement describes the principles for the negotiations toward the conclusion of a Detailed Agreement for the purchase of natural gas, that will be purchased in order to fulfill the Company's requirements after the conversion of its energy generation facilities from the use of fuel oil to natural gas, that will enable significant savings in fuel costs and further improvement in air quality. In July 2005, AIPM signed an agreement for the purchase of natural gas with Thetis Sea Group to provide its requirements in natural gas until mid 2011 for the currently operating facility in its Hadera site. The new agreement with EMG provides for the continued availability of gas, for the following 15 years. In addition, the agreement allows AIPM, within a limited timetable, to increase the contracted quantities to serve the needs of the new power plant which is being planned by AIPM. The estimated annual purchase from EMG will range from \$10 million up to \$50 million, according to the quantities acquired and the prevailing prices. Bank and corporate guarantees, of an order of one year purchase, will be provided by AIPM, when signing the Detailed Agreement.

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In February 2007, AIPM finalized the sale of all its direct and indirect holdings in T.M.M. to CGEA in an Agreement signed on January 04, 2007 (through a complete tender offer) (by agreement with CGEA for the sale of its holdings in Barthelemi) for a total amount of approximately \$27 million, so that AIPM has absolutely ceased to be a shareholder in T.M.M. For further details, please see the chapter on History and Development of the Company.

In the beginning of 2006, companies in the Group signed a three year agreement with Delek, for the purchase of fuel and oil for current use, in an aggregated amount of NIS 60 million per year for all the companies in the Group. This agreement will replace former agreements in similar amounts.

On July 29, 2005 the Company signed an agreement in London, with the Thetis Sea Group, for the purchase of natural gas. The gas that will be purchased is intended to fulfill the Company's requirements in the coming years, for the operation of the existing energy co-generation plant at Hadera that will be converted for the use of natural gas, instead of the current use of fuel oil. The overall financial volume of the transaction totals \$40 million over the term of the agreement (5 years from the initial supply of gas, but no later than July 1, 2011).

**D. Exchange Controls**

Foreign Exchange Regulations

There are no Israeli governmental laws, decrees or regulations that restrict or that affect the export or import of capital, including but not limited to, foreign exchange controls on remittance of dividends on the ordinary shares or on the conduct of the Group's operations, except as otherwise set forth in the paragraph below regarding taxation.

**E. Taxation**

The following information is regarding the Israeli laws only.

Investors are advised to consult their tax advisors with respect to the tax consequences of their purchases, ownership and sales of ordinary shares, including the consequences under applicable state and local law and federal estate and gift tax law, and the application of foreign laws or the effect of nonresident status on United States taxation. This tax summary does not address all of the tax consequences to the investors of purchasing, owning or disposing of the ordinary shares.

On July 24, 2002, the Israeli Knesset enacted income tax reform legislation, commonly referred to as the 2003 Tax Reform. The 2003 Tax Reform has introduced fundamental and comprehensive changes into Israeli tax laws. Most of the legislative changes took effect on January 1, 2003. The 2003 Tax Reform has introduced a transition from a primarily territorial-based tax system to a personal-based system of taxation with respect to Israeli residents. The Tax 2003 Reform has also resulted in significant amendment of the international taxation provisions, and new provisions concerning the taxation of capital markets including the abolishment of currently exempt investment routes (e.g., capital gains generated by Israeli individuals from the sale of securities traded on the Tel-Aviv Stock Exchange).

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Shortly after the 2003 Tax Reform, the Israeli Parliament approved on July 25, 2005 an additional income tax reform legislation (the 2006 Tax Reform) pursuant to the recommendations of a committee appointed by the Israeli Minister of Finance, which incorporated additional fundamental changes in Israeli tax law. Inter alia, The 2006 Tax Reform includes a gradual reduction of income tax rates for both individuals and corporations over the years through 2010, and outlined a path towards uniformity in the taxation of interest, dividend and capital gains derived from securities. Most of the amendments to the tax law are effective as of January 1, 2006, subject to certain exceptions. Transition rules apply in certain circumstances.

Various issues related to the effective date of 2003 Tax Reform and the 2006 Tax Reform remain unclear in view of the legislative language utilized and the lack of authoritative interpretations at this stage. The analysis below is therefore based on our current understanding of the new legislation.

Income Taxes on Dividends Distributed by the Company to Non-Israeli Residents

Subject to the provisions of applicable tax treaties, dividend distributions from regular profits (non-approved enterprise) by the Company to a non-resident shareholder are generally subject to withholding tax of 20%. The portion of dividends paid out of profits earned under an Approved Enterprise tax status of the Company is subject to withholding tax at the rate of 15% (in excess of the corporate tax paid by the Company when the dividend is paid of these profits 25% tax).

Generally, under the Tax Treaty Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income (US Treaty) the maximum rate of withholding tax on dividends paid to a shareholder who is a resident of the United States (as defined in the US Treaty) will be 25%. Due to the fact that a tax rate of 25% is higher than the maximum Israeli tax rate on dividends pursuant to the 2006 Tax Reform, the maximum tax rate should be 20%. However, when a U.S. tax resident corporation is the recipient of the dividend, the rate on a dividend out of regular (non-Approved Enterprise) profits may be reduced to 12.5% under the treaty, where the following conditions are met:

- (a) the recipient corporation owns at least 10% of the outstanding voting rights of the Company for all of the period preceding the dividend during the Company's current and prior taxable year; and

(b) generally not more than 25% of the gross income of the paying corporation for its prior tax year consists of certain interest and dividend income.

Otherwise, the usual rates apply.

In addition, If an Individual shareholder is considered a principal shareholder at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate on the dividend (not source from Approved Enterprise income) will be 25%. The withholding tax by the Company on such dividend would remain 20%.

United States individual citizens and residents and U.S. corporations generally will be required to include in their gross income the full amount of dividends received from the Company with respect to the ordinary shares owned by them, including the amount withheld as Israeli income tax. Subject to the limitations and conditions provided in the Internal Revenue Code of 1986, as amended (the Code), such persons may be eligible to claim a credit for such withheld amounts against their United States federal income tax liability. As an alternative, the persons enumerated above (provided such persons, in the case of individual taxpayers, itemize their deductions) may elect to deduct such withheld tax from their gross income in determining taxable income (subject to applicable limitations on the deductions claimed by individuals). However, such a credit or deduction may be limited for U.S. alternative minimum tax purposes, depending on the taxpayer's specific circumstances.

Dividend payments on the Ordinary Shares will not be eligible for a dividends received deduction generally allowed to United States corporations under the Code.

#### Income Taxes on Dividends Distributed by the Company to Israeli Residents

The distribution of dividend income to Israeli residents will generally be subject to income tax at a rate of 20% for individuals and will be exempt from income tax for corporations. The portion of dividends paid out of profits earned under an Approved Enterprise tax status of the Company, to both individuals and corporations, is subject to withholding tax at the rate of 15% (in excess of the corporate tax paid by the Company when the dividend is paid of these profits 25% tax).

In addition, If an Individual Israeli shareholder is considered a principal shareholder at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the Company, the tax rate on the dividend (not source from Approved Enterprise income) will be 25%. The withholding tax by the Company on such dividend would remain 20%.

#### **Tax on Capital Gains of Shareholders - General**

Israeli law imposes a capital gains tax on the sale of capital assets by an Israeli resident and on the sale of capital assets located in Israel or the sale of direct or indirect rights to assets located in Israel. The Israeli Tax Ordinance distinguishes between Real Gain and Inflationary Surplus. Real Gain is the excess of the total capital gain over Inflationary Surplus computed on the basis of the increase in the Israeli CPI between the date of purchase and the date of sale. The Real Gain accrued at the sale of an asset purchased on or after January 1, 2003 is generally taxed at a 20% rate for individuals and 25% for corporations. Inflationary Surplus, that accrued after December 31, 1993, is exempt from tax.

In July 2005 the Israeli Parliament approved a Reform in the Israeli taxation law, which among other decreases the corporate tax gradually from 31% in 2006 to 25% in 2010.

Pursuant to the 2006 Tax Reform the current applicable corporate tax rate in 2007 is to be gradually reduced from 29% to 25%, in the following manner: the tax rate for 2007 will be 29%, in 2008 27%, in 2009 26%, in 2010 and onwards 25%. The maximum tax rate for individuals is 48% and shall also be gradually reduced to 44% in 2010 and onwards. These rates are subject to the provisions of any applicable bilateral double taxation treaty. Israeli law generally imposes a capital gains tax on the sale of securities and any other capital assets.



**Capital gains Israeli Individuals**

The shareholder will generally be subject to tax at 20% rate on realized real capital gain accrued from January 1, 2003 and thereafter. To the extent that the shareholder claims a deduction of financing expenses, the gain will be subject to tax at a rate of 25% (until otherwise stipulated in bylaws that may be published in the future).

If such shareholder is considered a principal shareholder at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the Company, the tax rate will be 25%.

The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a taxpayer may elect the actual adjusted cost of the shares as the tax basis provided he can provide sufficient proof of such adjusted cost.

It should be noted that different taxation rules may apply to shareholders who purchased their shares prior to the listing on the Tel Aviv Stock Exchange. They should consult with their tax advisors for the precise treatment upon sale.

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**Capital gains Israeli Corporations**

It should be noted that different taxation rules may apply to shareholders who purchased their shares prior to the listing on the Tel Aviv Stock Exchange. They should consult with their tax advisors for the precise treatment upon sale.

Corporations which are subject to the Inflationary Adjustments Law

The shareholder will be subject to tax at the corporate tax rate on realized real capital gain (currently 29% in 2007).

**Corporations which are not subject to the Inflationary Adjustments Law**

Generally, the shareholder will be subject to tax at the corporate tax rate of 25% on realized real capital gains.

**Capital gains non-Israeli residents (Individuals and Corporations)**

Non-Israeli residents are generally exempt from capital gains tax on any gains derived from the sale of shares publicly traded on the Tel Aviv Stock Exchange provided, however, that such capital gains are not derived from a permanent establishment in Israel, that such shareholders are not subject to the Inflationary Adjustment Law and that such shareholders did not acquire their shares prior to an initial public offering. In addition, non-Israeli companies will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli company, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli company, whether directly or indirectly.

It should be noted that different taxation rules may apply to shareholders who purchased their shares prior to the listing on the Tel Aviv Stock Exchange. They should consult with their tax advisors for the precise treatment upon sale.

Notwithstanding the foregoing with respect to both Israeli and non-Israeli residents, dealers (both individuals and corporation) in securities in Israel are generally taxed at regular tax rates applicable to business income.

The U.S. Israeli Tax Treaty exempts U.S. residents who hold an interest of less than 10% an Israeli company, and who held an interest of less than 10% during the 12 months prior to a sale of their shares, from Israeli capital gains tax in connection with such sale. Certain other tax treaties to which Israel is a party also grant exemptions from Israeli capital gains taxes.

**F. Dividends and Paying Agents**

Not applicable to Annual Reports.

**G. Statement by Expert**

Not applicable to Annual Reports.

**H. Documents on display**

A copy of each document (or a translation thereof to the extent not in English) concerning the Company that is referred to in this Annual Report on Form 20-F, is available for public view at our principal executive offices at American Israeli Paper Mills Ltd., 1 Meizer Street Industrial Zone, Hadera 38100, Israel. We are subject to the information requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, we file reports and other information with the Securities and Exchange Commission (the "SEC").

Copies of this Annual Report and the exhibits hereto may be inspected and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549 at proposed rates. The public may obtain information on the operation of the SEC's Public Reference Room by calling the SEC in the United States at 1-800-SEC-0330.

Our reports and other information can also be inspected on EDGAR available on the SEC's website at [www.sec.gov](http://www.sec.gov).

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**ITEM 11 QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

Due to its operations, the Company is exposed to market risks, consisting primarily of changes in interest rates on both short and long-term loans, changes in exchange rates and changes in raw material and energy prices. These changes in interest rates effect the Company's financial results.

The Company's Board of Directors determines the policy according to which financial instruments are employed and defines the objectives to be attained, taking into account the Group's linkage balance sheet and the impact of changes in various currencies and in the Consumer Price Index on the Company's cash flows and on its financial statements.

AIPM conducts calculations of the its exposure every month and examines the compliance with the policy determined by the Board of Directors.

Furthermore, limited use is made of derivative financial instruments, which the Company employs for hedging the cash flows, originating from the existing assets and liabilities.

Such transactions are conducted primarily through currency options and forward transactions opposite Israeli banking institutions. The Company therefore believes that the inherent credit risk of these transactions is slight.

As of December 31, 2006 AIPM owns CPI-linked long-term loans (notes) in the total sum of about NIS 226 million. The interest on such loans is not higher than the market interest rate. In the event that the inflation rate shall rise significantly, a loss may be recorded in AIPM's financial statements, due to the surplus of CPI-linked liabilities.

In order to hedge this exposure, AIPM has entered into forward transactions, in December 2006 and January 2007 for hedging NIS 220 million against a rise in the CPI until December 2007. These transactions serve to replace hedging transactions of NIS 230 million that terminated in late 2005.

Through our normal operations, we are exposed to market risks mainly to the changes in the Consumer Price Index, which our notes are linked to. We manage our exposure to these market risks through our regular financing activities and, when deemed appropriate, we hedge these risks through the use of derivative financial instruments. We use the term hedge to mean a strategy designed to manage risks of volatility movements on certain liabilities. The gains or losses on derivative instruments are expected to offset the losses or gains on these liabilities. We use derivative financial instruments as risk hedging tools and not for trading or speculative purposes. Our risk management objective is to minimize the effect of volatility on our financial results exposed to these risks and appropriately hedging them with forward contracts.

**Maturity**

	<b>2007</b>	<b>2008-9</b>	<b>2010-11</b>	<b>More than 5 years</b>	<b>Total book value</b>	<b>Total fair value</b>
Series 1 Debentures	6,841	13,681			20,522	20,183
Series 2 Debentures	29,518	59,036	59,036	59,037	206,627	211,284

**Credit Risks**

The Company and its subsidiaries' cash and cash equivalents and the short-term deposits as of December 31, 2006 are deposited mainly with major Israeli banks. The Company and its subsidiaries consider the credit risks in respect of these balances to be immaterial.

Most of these companies' sales are made in Israel, to a large number of customers. The exposure to credit risks relating to trade receivables is limited due to the relatively large number of customers. The Group performs ongoing credit evaluations of its customers to determine the required amount of allowance for doubtful accounts. The Company believes that an appropriate allowance for doubtful debts is included in the financial statements.

Fair Value of Financial Instruments

The fair value of the financial instruments included in working capital of the Group is usually identical or close to their carrying value. The fair value of loans and other liabilities also approximates the carrying value, since they bear interest at rates close to the prevailing market rates, except as described below.

**Sensitivity Analysis Tables for Sensitive Instruments, According to Changes in Market Elements**

All other Company's market risk sensitive instruments are instruments entered into for purposes other than trading purposes.

**Sensitivity to Interest Rates**

Sensitive Instruments	Profit (loss) from changes		Fair value as at Dec-31-06	Profit (loss) from changes	
	Interest rise 10%	Interest rise 5%		Interest decrease 10%	Interest decrease 5%
<b>In NIS thousands</b>					
Series 1 Debentures	140	70	20,183	-141	-70
Series 2 Debentures	3,597	1,810	211,284	-3,696	-1,835
Other liability	148	74	31,210	-149	-74
Long-term loans and capital notes - granted	-294	-147	-62,005	297	148

The fair value of the loans is based on a calculation of the present value of the cash flows, according to the generally-accepted interest rate on loans with similar characteristics (5% in 2006).

Regarding the terms of the debentures and other liability - See Note 4 to the Financial Statements.

Regarding the terms of the long-term loans and capital notes granted - See Note 2 to the Financial Statements.

**Sensitivity to Consumer Price Index**

Sensitive Instruments	Profit (loss) from changes		Fair value as at Dec-31-06	Profit (loss) from changes	
	Interest rise 0.2%	Interest rise 0.1%		Interest decrease 0.2%	Interest decrease 0.1%
<b>In NIS thousands</b>					
NIS-CPI forward transaction	202	101	-1,274	-202	-101

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See Note 12a to the Financial Statements.

**Sensitivity to US Dollar Exchange Rate**

Sensitive Instruments	Profit (loss) from changes		Fair value as at Dec-31-06	Profit (loss) from changes	
	Revaluation of \$ 10%	Revaluation of \$ 5%		Devaluation of 10%	Devaluation 5%

## Sensitivity to US Dollar Exchange Rate

	In NIS thousands				
Other accounts receivable	5,985	2,992	59,849	-5,985	-2,992
Capital note	634	317	6,337	-634	-317
Accounts payable	-842	-421	8,422	842	421

Other accounts receivable reflect primarily short-term customer debts.

Capital note See Note 2b to the Financial Statements.

Accounts payable reflect primarily short-term liabilities to suppliers.

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**Quantitative Information Regarding Market Risk**

The following are the balance-sheet components by linkage bases at December 31, 2006:

In NIS Millions	Unlinked	CPI-linked	In foreign currency, or linked thereto (primarily US\$)	Non-monetary items	Total
<b>Assets</b>					
Cash and cash equivalents	5.0		8.6		13.6
Other accounts receivable	243.1	0.2	59.8	11.7	314.8
Inventories				62.1	62.1
Investments in associated companies	63.7		6.3	305.5	375.5
Deferred taxes on income				6.5	6.5
Fixed assets, net				400.8	400.8
<b>Total assets</b>	<b>311.8</b>	<b>0.2</b>	<b>74.7</b>	<b>786.6</b>	<b>1,173.3</b>
<b>Liabilities</b>					
credit from banks	203.0				203.0
Accounts payable	191.5		8.4		199.9
Deferred taxes on income				41.7	41.7
Notes (bonds) - including current maturities		226.4			226.4
Long term loans	38.7				38.7
Other liabilities - including current maturities	32.8				32.8
Shareholders' equity, funds and retained earnings				430.8	430.8
<b>Total liabilities and equity</b>	<b>466.0</b>	<b>226.4</b>	<b>8.4</b>	<b>472.5</b>	<b>1,173.3</b>
Surplus financial assets (liabilities) as at December 31, 2006	<b>(154.2)</b>	<b>(226.2)</b>	<b>66.3</b>	<b>314.1</b>	<b>-</b>

**ITEM 12 DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable to Annual Reports.

**ITEM 13 DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14 MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

None.

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**ITEM 15T CONTROLS AND PROCEDURES**

**(a) Disclosure controls and procedures**

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure, controls and procedures (as defined in the U.S. Securities Exchange Rule 13a-15(e) and 15d-15(e)) have concluded that as of the end of the period covered by this Form 20-F, our disclosure controls and procedures were effective to ensure that material information required to be disclosed in the reports that we file and furnish under the Exchange Act as recorded, processed and summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and regulations.

**(b) Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect material misstatements. Also, projection of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance, with the policies and procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2006 based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As permitted, we have excluded from our evaluation the affiliated companies: T.M.M. Integrated Recycling Industries Ltd, Barthelemi Holdings Ltd, Frenkel C.D. Limited, Carmel Container Systems Limited, Cycle-Tec Recycling Technology Ltd, and Hogla- Kimberly Lt d. (H-K) (which together, not including H-K, are referred to as the excluded companies), which are included in our 2006 Consolidated Financial Statements. The aggregate Company's investments in the excluded companies represented 5% of consolidated total assets and the aggregate Company's share in net income of the excluded companies represented 11% of consolidated net income (loss) for the year ended December 31, 2006. Hogla- Kimberly Ltd. has a significant influence on 2006 Consolidated Financial Statements; however, H-K had her evaluation separately, as part of Kimberly Clark Ltd. (parent company) 2006 evaluation.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective.

(c) This annual report on Form 20-f does not include an attestation report of our independent registered public accounting firm regarding management's assessment of the Company's internal control over financial reporting. Management's report was not subject to audit by our independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission, which permit us to defer obtaining such report until our fiscal year ending December 31, 2007.

**(d) Changes in Internal Control Over Financial Reporting.**

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2006 that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The Audit Committee maintains a policy of approving and recommending only those services to be performed by the Company's external auditors which are permitted under the Sarbanes-Oxley Act and the applicable rules of the SEC relating to auditor's independence, and which are otherwise consistent with and will encourage, and are remunerated at levels that accord with, the basic principles of auditor independence. The practice of the Audit Committee is to receive from the Company's management, a list of all services, including audit, audit-related, tax and other services, proposed to be provided during the current fiscal year to the Company and its subsidiaries by Kesselman & Kesselman, an affiliate of PricewaterhouseCoopers. After reviewing and considering the services proposed to be provided during the current fiscal year and, where appropriate in order better to understand their nature, discussing them with management, the Audit Committee pre-approves such of the proposed services, with a specific pre-approved budget, as it considers appropriate in accordance with the above principles. Additional services from Kesselman & Kesselman and any increase in budgeted amounts will similarly be pre-approved during the year by the Audit Committee on a case-by-case basis.

All audit-related and non-audit-related services performed by Kesselman & Kesselman during 2006 were reported to, and the services proposed to be provided by them during 2006 were pre-approved by the Audit Committee, in accordance with the procedures outlined above.

The following table provides information regarding fees we paid to Kesselman & Kesselman for all services, including audit services, for the years ended December 31, 2006 and 2005, respectively.

	U.S. \$ in thousands	
	2006	2005
Audit Fees	150	120
Audit Related Fees	-	30*
<b>Total</b>	<b>150</b>	<b>150</b>

\* Consulting fees regarding the establishment of processes pursuant of Section 404 of the Sarbanes Oxley Act.

**Audit Fees** are the aggregate fees billed for the audit of our annual financial statements. This category also includes services that generally the independent accountant provides, such as statutory audits, consents and assistance with and review of documents filed with the SEC.

**Audit-Related Fees** are the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit and are not reported under Audit Fees. These fees include mainly accounting consultations regarding the accounting treatment of matters that occur in the regular course of business, implications of new accounting pronouncements and other accounting issues that occur from time to time.

**Tax Fees** are the aggregate fees billed for professional services rendered for tax compliance, tax advice, other than in connection with the audit. Tax compliance involves preparation of original and amended tax returns, tax planning and tax advice.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Neither the Company nor any affiliated purchaser purchased any of the Company's equity securities during 2006.



**PART III**

**ITEM 17 FINANCIAL STATEMENTS**

See Item 19 below for Consolidated Financial Statements filed as a part of this Annual Report.

The Company prepares its financial statements in accordance with Israeli GAAP. The effect of the material differences between Israeli GAAP and U.S. GAAP, as it relates to the Company, are described below:

**a. The functional currency of the Company**

Through December 31, 1993, the financial statements of the Company, presented in NIS values adjusted for the changes in the general purchasing power of the Israeli currency based on the changes in the exchange rate of the dollar were also used for the purposes of reporting in conformity with U.S. GAAP applicable to entities operating in hyper-inflationary economic environments, as prescribed by Statement No. 52 of the Financial Accounting Standards Board of the United States (FASB). Since the inflation rate in Israel has decreased considerably, the Company decided that, commencing in 1994, it would implement the rules relating to economies no longer considered hyper-inflationary, for reporting purposes, in accordance with U.S. GAAP.

Under those rules:

- 1) The functional currency of the Company (the currency in which most income is derived and most expenses are incurred) is the New Israeli Shekel (NIS);
- 2) The opening balances for 1994 are the balances presented in the Company's balance sheet at December 31, 1993;
- 3) Transactions performed from January 1, 1994 are presented on the basis of their original amounts in Israeli currency.

The term "Re-measured NIS" signifies the currency used for FASB 52 purposes, as described above.

As to the effect of application of these rules see (h) below.

As to the discontinuance of the adjustment of the financial statements under Israeli GAAP, to the exchange rate of the dollar as from January 2004, see Note 1b to the Financial Statements.

**b. Deferred income taxes**

Under Israeli GAAP, no deferred taxes have been provided through December 31, 2004 in respect of certain long-lived (more than 20 years) assets, such as buildings and land. Under U.S. GAAP, in accordance with the provisions of FAS 109, income taxes are to be provided for any assets that have a different basis for financial reporting and income tax purposes. Following the adoption of Israeli Standard No. 19 in 2005, except for land that originated from business combinations consummated prior to January 1, 2005, these differences no longer exist.

In addition, for U.S. GAAP purposes deferred taxes are to be provided for with respect to un-remitted earnings of investee companies. Under Israeli GAAP due to the Company's policy to hold its investments in investee companies, and not to realize them, these temporary differences are considered differences permanent in duration for which deferred taxes are not provided for.

Through 1999, as long as the main investments of the Company were subsidiaries which were controlled by the Company, the Company did not provide for deferred taxes also for U.S. GAAP reporting purposes, since those differences were deemed to be not taxable due to the tax free inter-company dividend distribution law in Israel and tax planning on its behalf, accordingly.

As from 2000, due to changes in certain of the Company's investments from subsidiaries to associated companies, deferred taxes were provided for any portion that arose from investee companies sources other than pre-1993 undistributed earnings (taking into account the Company's tax strategy).

As to the effect of application of this treatment, see (h) below.

**c. Stock based compensation**

Under Israeli GAAP, and up until December 31, 2005 no compensation expenses were recorded in respect of employee stock options. Commencing January 1, 2006, the company applies Israel Accounting Standard No. 24 of the IASB, Share-Based Payment (hereafter - Standard 24), which prescribes the recognition and measurement principles, as well as the disclosure requirements, relating to share-based payment transactions.

However, since the company has not granted any equity-settled awards, nor made modifications to existing grants, subsequent to March 15, 2005, the transition date for as prescribed in the Israeli standard, the measurement criteria of the standard do not apply to past grants made by the company, and its application has not had any effect on the measurements of the stock based compensation expenses.

Under Israeli GAAP, prior to the adoption of Standard 24, there were no compensation expenses recorded in respect of share based payments. However, upon exercise, the tax benefit is credited to shareholders equity. The U.S. GAAP adjustment of NIS (2,414) in 2006 and NIS (401) in 2005 to shareholders' equity is required to reverse the credit to equity upon exercise.

For U.S. GAAP purposes, prior to January 1, 2006 the Company accounted for employee stock based compensation under the intrinsic value model in accordance with Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees ( APB 25 ) and related interpretations. In accordance with FAS 123 Accounting for Stock-Based Compensation ( FAS 123 ), the Company disclosed pro forma data assuming the Company had accounted for employee stock option grants using the fair value-based method defined in FAS 123.

In December 2004, the Financial Accounting Standards Board ( FASB ) issued the revised Statement of Financial Accounting Standards ( FAS ) No. 123, Share-Based Payment ( FAS 123R ), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC's interpretation of FAS 123R.

FAS 123R eliminates the ability to account for employee share-based payment transactions using APB 25 -, and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant-date fair value as previously calculated for the pro-forma disclosure under FAS 123.

Compensation expense for outstanding awards for which the requisite service had not been rendered as of the effective date will be recognized over the remaining service period using the compensation cost calculated for pro-forma disclosure purposes under FAS 123, taking into account the forecasted forfeiture rate.

The Company adopted FAS 123R, as of January 1, 2006, using the modified prospective application transition method, as permitted by FAS 123R. Under such transition method, the Company's financial statements for periods prior to the effective date of FAS 123R (January 1, 2006) have not been restated. The adoption of FAS 123R resulted in a net gain representing the cumulative effect of a change in accounting principle in an amount of approximately NIS 0.2 million net of tax, which reflects the net cumulative impact of estimating future forfeiture in the determination of period expense, rather than recording forfeitures when they occur as previously required.

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The fair value of stock options granted with service conditions, was determined using the Black-Scholes option pricing model, which is consistent with the Company's valuation techniques previously utilized for options in footnote disclosures required under FAS 123 and FAS 148. Such value is recognized as an expense over the service period, net of estimated forfeitures, using the accelerated method of amortization under FAS 123R.

The estimation of stock awards that will ultimately vest requires significant judgment, and to the extent actual results or updated estimates differ from the Company's current estimates, such amounts will be recorded as a cumulative adjustment in the period those estimates are revised. The Company considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from the Company's current estimates.

As of December 31, 2006 all options are fully vested.

The following table illustrates the effect on net income and EPS assuming the Company had applied the fair value recognition provisions of FAS 123 to its stock based employee compensation for the years presented prior to the adoption of FAS 123R:

	<b>Year ended December 31</b>	
	<b>2005</b>	<b>2004</b>
	<b>NIS in thousands, except for per share data</b>	
Net income, as reported under U.S. GAAP	41,861	58,720
Add (deduct):		
stock based employee compensation expense (reversal), included in reported net income, net of related tax effect	(1,838)	8,458
Deduct:		
stock based employee compensation expense -determined under fair value method for all awards, net of related tax effect	(939)	(3,523)
Pro forma net income -under U.S. GAAP	39,084	63,655
Earnings per share - under U.S. GAAP:		
Basic - as reported	10.47	14.76
Basic - pro forma	9.77	16.00
Diluted - as reported	10.33	14.52
Diluted - pro forma	9.65	15.74

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A summary of the status of the Company's plans as of December 31, 2006, 2005 and 2004, and changes during the years ended on those dates, is presented below:

	<b>2006</b>		<b>2005</b>		<b>2004</b>	
	<b>Number</b>	<b>Weighted average exercise Price NIS</b>	<b>Number</b>	<b>Weighted average exercise Price NIS</b>	<b>Number</b>	<b>Weighted average exercise Price NIS</b>
Options outstanding at						
beginning of year	127,571	114.03	152,103	132.74	216,243	159.15
Changes during the year:						
Exercised	(55,090)	94.01	(16,282)	143.38	(64,140)	153.82
Forfeited	(37,056)	102.06	(8,250)	178.25		

c. Stock based compensation

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	2006		2005		2004	
Options outstanding at end of year	35,425	122.21	127,571	114.03	152,103	132.74
Options exercisable at year-end	*35,425	127.35	78,996	87.61	54,953	99.98

\* Represents the number of options fully vested as of December 31, 2006. Based upon the Company's share market value as of December 31, 2006, this reflects potentially 11,113 shares regarding the options exercisable at year-end.

The following table summarizes information about options outstanding at December 31, 2006.

**Options outstanding and exercisable**

Exercise Prices	Number of options at December 31, 2006	Average remaining contractual life
NIS		Years
106.44	6,550	0.5
132.09	28,875	1.5
	<b>35,425</b>	<b>1.3</b>

**d. Earnings per share ( EPS )**

Israeli GAAP relating to computation of EPS was changed as of January 1, 2006 with retroactive effect. As to the provisions of the new standard see note 1r to the financial statements attached.

The EPS computation according to U.S. GAAP presented below is in accordance with FAS 128.

As applicable to the Company, after the implementation of the new Israeli standard No. 21 there are no material GAAP differences with regard to the computation of the basic EPS however there is a difference in the computation of the diluted EPS as follows:

The computation of the diluted EPS under US GAAP requires that the unamortized compensation expenses related to employee stock options will be included in the total amount of the assumed proceeds used in applying the treasury stock method, while under Israeli GAAP this amounts is not taken into account.

As to the effect of application of U.S. GAAP, see (h) below.

Following are data relating to the weighted average number of shares for the purpose of computing basic and diluted earnings per share under U.S. GAAP:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Weighted average number of shares used in the computation of basic earnings per share	4,025,181	3,999,910	3,978,339
Net additional shares from the assumed exercise of employee stock options	30,447	51,700	65,375
Weighted average number of shares used in the computation of diluted earnings per share	<u>4,055,628</u>	<u>4,051,610</u>	<u>4,043,714</u>

**e. Investment in marketable equity securities accounted for by the equity method (associated companies) Carmel Container Systems (Carmel) and T.M.M. Integrated Recycling Industries Ltd (T.M.M.)**

**Carmel**

Under Israeli GAAP, an investment in an associated company is tested for impairment under the provisions of Israeli Standard No. 15 of the Israeli Accountant Standard Board - Impairment of Assets (see note 1h to the financial statements). Based on the provisions of this Standard, and as explained in note 2f to the financial statements, the Company determined that the recoverable value of the investment in Carmel exceeds its carrying value (based, among other, on its Discounted Cash Flows), and accordingly, the investment was not written down.

Under U.S. GAAP (APB 18 - The Equity Method of Accounting for Investments in Common Stock ), SEC Staff Accounting Bulletin (SAB) No. 59 ( Accounting for Non current Marketable Equity Securities ) and EITF 03-1 (The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments), a decline in value of investment in an associated company which is other than temporary was recognized as a realized loss in 2003, establishing a new carrying value for the investment. Factors considered in determining that a decline is other than temporary included, among other, the length of time and the extent to which the market value has been less than the carrying value of the investment. The relevant market value for determining the impairment loss is the market value at December 31, 2003.

Therefore, although according to the Israeli GAAP the recoverable value of this investment exceeds its carrying value (see above) under U.S. GAAP and SEC rules described above, the decline in the market value of Carmel shares was the significant factor in determining other than temporary decline. Accordingly, for U.S.GAAP reporting, since the decline in the market value of Carmel was long and extensive, the Company reduced the carrying value of this investment to its market value as of December 31, 2003 and recorded an impairment loss amounting NIS 16,986,000.

Under US GAAP- Since there is no goodwill or non amortizable assets, the impairment was attributed only to Carmel s fixed assets; therefore the Company amortizes the impairment at the rates applicable to Carmel s fixed assets. The amortization of the impairment, as above, resulted in an increase in the share in profits of the associated company amounting to NIS 1,699 thousands in the years 2006, 2005 and 2004.

**T.M.M.**

Under Israeli GAAP, an investment in an associated company is tested for impairment under the provisions of Israeli Standard No. 15 of the Israeli Accountant Standard Board - Impairment of Assets (see note 1h to the financial statements). Until December 31, 2005 based on the provisions of this Standard, a the Company determined that the recoverable value of the investment in T.M.M. based on an outside appraiser exceeds its carrying value (based, among other, on its Discounted Cash Flows), and accordingly, the investment was not written down.

As a result of the implementation of Accounting Standard No. 15, T.M.M recorded a loss of NIS 12.5 million from the impairment of fixed assets in the third quarter of 2006, based on the estimate of an external assessor. The Company's share in this loss (43.08%) amounts to NIS 5.4 million. This sum appears as part of the Company's share in the earnings (losses) of associated companies for that year.

At the beginning of 2007 the Company sold its holdings in T.M.M. in consideration of a sum approximately similar to the book value, after taking into account the impairment, which was done during 2006.

Under U.S. GAAP (APB 18 - The Equity Method of Accounting for Investments in Common Stock), SEC Staff Accounting Bulletin (SAB) No. 59 (Accounting for Non-current Marketable Equity Securities), and EITF 03-1 (The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments), a decline in value of investment in an associated company which is other than temporary was recognized as a realized loss in 2005, establishing a new carrying value for the investment. Factors considered in determining that a decline is other than temporary included, mainly, the length of time and the extent to which the market value has been less than the carrying value of the investment. The relevant market value for determining the impairment loss is the market value at December 31, 2005.

Therefore, although according to the Israeli GAAP the recoverable value of this investment exceeded its carrying value (see above) under U.S. GAAP and SEC rules described above, the decline in the market value of T.M.M. shares was the significant factor in determining other than temporary decline. Accordingly, for U.S.GAAP reporting, since the decline in the market value of T.M.M. was long and extensive, the Company reduced the carrying value of this investment to its market value as of December 31, 2005 and recorded an impairment loss amounting NIS 10,000,000.

The losses of T.M.M. and Barthelemi for the year 2006 under U.S. GAAP including impairment in value of fixed assets and goodwill, amount to NIS 21.6 million. The Company's share in this impairment charged approximately NIS 8.7 million. Due to the impairment recorded in the Company's books in 2005 the Company's share in the operating results of those investment for 2006 was determined, based on their actual results, net of the impairment, already reflected in 2005. As a result under U.S. GAAP the book value of T.M.M. is similar to the value under Israeli GAAP, as mentioned above.

**f. Reclassification of deferred charges**

Under Israeli GAAP, in accordance with a new Israeli Standard No. 22, commencing January 1, 2006 see also note 1o to the financial statements:

The balance of deferred debt issuance costs, which at December 31, 2005 amounted to NIS 946 thousands, is reclassified and presented as a deduction from the amount of the liabilities to which such expenses relate. Under U.S. GAAP deferred charges should be classified as other assets, see h.3. below. The reclassifications have no impact on net income as both costs are accreted/amortized to the income statement over the term of the debt.

**g. Leasehold rights from the Israel Land Administration Authority (ILAA)**

Under Israeli GAAP, land lease rights from the ILAA are accounted for as fixed assets, and not depreciated.

Under US GAAP, in accordance with SFAS 13 Accounting for Leases, leases involving real estate can be accounted for as capital lease only when (a) the lease transfers ownership of the property to the lessee by the end of the lease term or (b) the lease contains a bargain purchase option. Since none of the above-mentioned terms is met, leasehold rights are accounted for as an operating lease. The leasehold rights are amortized over the period of the initial option and if applicable the renewal option period (See j below).

**h. The effect of applying U.S. GAAP on the consolidated financial statements is as follows:**

## 1) Consolidated statement of income figures:

	<b>Year ended December 31</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>NIS in thousands (except per share data)</b>			
Net income, as reported according to Israeli GAAP	13,330	45,715	62,732
Effect of treatment of the following items in accordance with U.S. GAAP:			
Functional currency, see a above	6,970	6,490	2,385
Deferred income taxes - net, see b above	(2,757)	(3,961)	(2,080)
Reconciliation resulting from the Company's share in the adjustments of the associated companies.	5,278	80	2,442
Other than temporary impairment of an investment in associated companies, see e above		(10,000)	
Amortization of other than temporary impairment of an investment in an associated company, see e above	1,699	1,699	1,699
Amortization of leasehold rights from the ILAA, see g above	(596)	-	-
Applying FAS 123R in respect of employee stock options, see c above:			
Gross amount	(373)	-	-
Deferred taxes	116	-	-
Applying APB 25 in respect of employee stock options, see c above:			
Gross amount		3,093	(12,660)
Deferred taxes		(1,255)	4,202
Cumulative effect at beginning of period, net of tax of NIS 127*, see c above	242	-	-
	<u>23,909</u>	<u>41,861</u>	<u>58,720</u>
Net income under U.S. GAAP			
Earnings per share, see d above:			
Basic	5.94	10.47	14.76
Diluted	5.89	10.33	14.52

\*As a result of the adoption of FAS 123R, see (c) above.

## 2) Shareholders' equity:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>In thousands</b>		
Shareholders' equity according to Israeli GAAP	430,842	523,384
Effect of treatment of the following items in accordance with US GAAP:		
Functional currency	(41,472)	(48,442)
Amortization of leasehold rights	(596)	
Investments in associated companies	7,880	2,602
Other than temporary impairment of an investment in an associated companies, net of amortization	(21,890)	(23,588)
Elimination of exercise options into shares	(2,414)	(401)

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	<b>December 31</b>	
	<u>          </u>	<u>          </u>
Cumulative effect, at beginning of year of SAB 108, net of tax	(2,665)	-
Deferred income taxes	5,083	7,851
	<u>          </u>	<u>          </u>
Shareholders' equity under US GAAP	374,768	461,406
	<u>          </u>	<u>          </u>



## 3) Consolidated balance sheet figures:

	December 31			
	2006		2005	
	NIS	Re-measured NIS	NIS	Re-measured NIS
	In thousands			
As Reported Under				
	Israeli GAAP	U.S. GAAP	Israeli GAAP	U.S. GAAP
<u>Assets</u>				
Inventories	62,109	60,131	63,999	59,885
Investment in associated companies	375,510	362,199	428,957	407,971
Fixed assets - net	400,823	362,539	379,934	340,914
Deferred charges	-	785	946	946
<u>Liabilities and shareholders' equity</u>				
Deferred taxes - net	27,267	29,786	33,022	31,077
Notes	226,364	227,149	234,638	234,638
Shareholders' equity**	430,842	374,768	523,384	461,406

\*\* 2006 retained earnings are net of an adjustment of NIS (2,665) thousands, net of tax, related to the adoption of SAB 108 (See j below).

## i. Statement of cash flows

The Company presents its cash flow information, under Israeli GAAP net of the effects of inflation.

The information to be included under US GAAP for the years ended December 31, 2004, 2005 and 2006 is presented below:

	2006	2005	2004
	NIS		
	In thousands		
Net cash provided by operating activities	64,521	94,143	30,096
Net cash used in investing activities	(50,410)	(19,868)	(42,043)
Net cash used in financing activities	(8,808)	(73,770)	(138,946)

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	<u>2006</u>	<u>2005</u>	<u>2004</u>
Increase (decrease) in cash and cash Equivalents	5,303	505	(150,893)
Balance of cash and cash equivalents at beginning of year	<u>8,318</u>	<u>7,813</u>	<u>158,706</u>
Balance of cash and cash equivalents at end of year	<u>13,621</u>	<u>8,318</u>	<u>7,813</u>

Under Israeli GAAP, cash flows relating to investments in, and proceeds from the sale of, marketable securities classified as a current investment are presented as investing activities in the statements of cash flows, while under U.S. GAAP, these securities should be classified as operating activities.

**j. Adoption of SAB 108 Accounting for the Effects of Prior year Misstatements when Quantifying Misstatements in current year financial statements**

In September 2006, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 addresses the diversity in practice of quantifying financial statement misstatements resulting in the potential build up of improper amounts on the balance sheet. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for companies with fiscal years ending after November 15, 2006 and SAB 108 allows a one-time transitional cumulative effect adjustment to beginning retained earnings, in the first year of adoption, for errors that were not previously deemed material, but are material under the guidance in SAB 108.

Additionally, the use of the cumulative effect transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Company has adopted SAB No. 108. The adoption of SAB No. 108 had an effect of NIS 2,665 thousand, net of tax, on the consolidated retained earnings due to the GAAP differences related to the leases from the Israeli administration, see note g above.

**k. Recently issued accounting pronouncements in the United States:**

**1. SFAS 155 - Accounting for certain Hybrid Financial Instruments, an amendment of FASB statements No.133 and 140**

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140" (SFAS No. 155). SFAS No. 155 allows financial instruments that contain an embedded derivative and that otherwise would require bifurcation to be accounted for as a whole on a fair value basis, at the holders' election. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. This statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006 (January 1, 2007 for the Company). The adoption of SFAS No. 155 is not expected to have a material impact on the Company's consolidated financial condition or results of operations.

**2. FIN 48 Accounting for uncertainty in Income Taxes, an interpretation of SFAS No. 109**

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an Interpretation of SFAS No. 109". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes", by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under FIN 48, the financial statement effects of a tax position should initially be recognized when it is more likely than not, based on the technical merits, that the position would be sustained upon examination. A tax position that meets the more-likely-than-not recognition threshold should initially and subsequently be measured as the largest amount of tax benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement with a taxing authority. The cumulative effect, if any, of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of

retained earnings in the period adopted. FIN 48 also requires additional disclosures about unrecognized tax benefits associated with uncertain income tax positions and a reconciliation of the change in the unrecognized benefit. In addition, FIN 48 requires interest to be recognized on the full amount of deferred benefits for uncertain tax positions. An income tax penalty is recognized as expense when the tax position does not meet the minimum statutory threshold to avoid the imposition of a penalty. The Company is currently evaluating the impact that the adoption of FIN 48 will have on its consolidated financial position and results of operations.

### **3. SFAS 157 Accounting for fair value Measurement**

In September 2006, the FASB issued SFAS No. 157 ( SFAS 157 ), Fair Value Measurements , which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies in conjunction with other accounting pronouncements that require or permit fair value measurements. This Statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have on its consolidated financial position and results of operations.

### **4. SFAS 159 Accounting for the Fair Value Option For Financial Assets and Financial Liabilities**

In February 2007, the FASB issued SFAS No. 159 ( SFAS 159 ), The Fair Value Option for Financial Assets and Financial Liabilities , to permit all entities to choose, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company), with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157, Fair Value Measurements. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. SFAS No. 159 also applies to eligible items existing at November 15, 2007 (or early adoption date). The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial position and results of operations.

### **5. EITF 06-03 Accounting for Presentation of Taxes Collected from Customers and remitted to Governmental Authorities**

In June 2006, the Emerging Issues Task Force, reached a consensus on Issue No. 06-03, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)". EITF 06-03 relates to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction. EITF 06-03 states that the presentation of the taxes, either on a gross or net basis, is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies, if those amounts are significant. EITF 06-03 should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006 (as of January 1, 2007 for the Company). The Company's policy is to recognize revenue net of VAT, accordingly. The Company does not expect that the adoption of EITF 06-03 will have a material effect on its financial position and results of operations.

## Schedule Valuation and Qualifying Accounts

Three Years Ended December 31, 2006

Column A	(NIS in thousands)			
	Column B	Column C	Column D	Column E
	Balance at beginning of period	(reductions) Additions charged to expenses	Deductions	Balance at end of period
Allowance for doubtful accounts:				
Year ended December 31, 2006	16,914	(123)	-	16,791
Year ended December 31, 2005	16,148	840	(74)	16,914
Year ended December 31, 2004	13,696	3,102	(650)	16,148

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**ITEM 19 - EXHIBITS**

(a) The following financial statements and supporting documents are filed with this report:

- (i) Consolidated Audited Financial Statements of the Company for the year ended December 31, 2006 (including Reports of Independent Registered Public Accounting Firms).
- (ii) Financial Statements of Mondy Business Paper Hadera Ltd. for the year ended December 31, 2006.
- (iii) Financial Statements of Hogla-Kimberly Ltd. for the year ended December 31, 2006.
- (iv) Report of Independent Registered Public Accounting Firms on Schedule on Valuation and Qualifying Accounts.
- (v) Report of Independent Registered Public Accounting Firms on reconciliation to U.S. GAAP.
- (vi) Report of Independent Registered Public Accounting Firms for affiliated companies.

(b) Exhibits:

- 1.1\* Memorandum of Association
- 1.2\*\* Articles of Association Voting Agreement dated February 5, 1980 by and among Clal Industries Ltd., PEC Israel Economic Corporation and Discount Bank Investment Corporation Ltd.
- 3.1\*\*\* Voting Agreement dated February 5, 1980 by and among Clal Industries Ltd., PEC Israel Economic Corporation and Discount Bank Investment Corporation Ltd.
- 31.1 Certification of Chief Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act.
- 31.2 Certification of Chief Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act.

\* Previously filed as an exhibit to the Company's Annual Report on Form 20-F for the year ended December 31, 1987, file No. 1-4212, and incorporated by reference herein.

\*\* Previously filed as an exhibit to the Company's Annual Report on Form 20-F for the year ended December 31, 2005, filed with the SEC in June 2006 and incorporated by reference herein.

\*\*\* Incorporated by reference to the exhibit number 3.1 in the Company's form 20-F for the year ended December 31, 1987.

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

AMERICAN ISRAELI PAPER MILLS LIMITED

By: /s/ Lea Katz

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Name: Lea Katz  
Title: Corporate Secretary

Dated: June 28, 2007

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
2006 CONSOLIDATED FINANCIAL STATEMENTS

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## AMERICAN ISRAELI PAPER MILLS LIMITED

## CONSOLIDATED BALANCE SHEETS

		December 31		
		Note	2006	2005
		NIS in thousands (see note 1b.)		
<b>Assets</b>				
<b>CURRENT ASSETS:</b>				
	8			
Cash and cash equivalents	1q		13,621	8,318
Marketable securities	1f		--	11,416
Accounts receivable:	10a			
Trade			168,050	150,409
Other			146,684	106,124
Inventories	10b		62,109	63,999
			<u>390,464</u>	<u>340,266</u>
Total current assets				
<b>INVESTMENTS AND LONG-TERM RECEIVABLES:</b>				
Investments in associated companies	2;8		375,510	428,957
Deferred income taxes	7f		6,490	5,655
			<u>382,000</u>	<u>434,612</u>
<b>FIXED ASSETS:</b>				
	3			
Cost			1,109,239	1,057,911
Less - accumulated depreciation			708,416	677,977
			<u>400,823</u>	<u>379,934</u>
<b>DEFERRED CHARGES,</b>				
net of accumulated amortization	li			946
			<u>1,173,287</u>	<u>1,155,758</u>
Total assets			<u>1,173,287</u>	<u>1,155,758</u>

/s/ Zvi Livnat

\_\_\_\_\_)Chairman of the  
Zvi Livnat )Board of Directors

/s/ Avi Brener

\_\_\_\_\_)  
Avi Brener )Chief Executive Officer

/s/ Israel Eldar

\_\_\_\_\_)  
**Israel Eldar** )**Controller**

Date of approval of the financial statements: 7 March 2007

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

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	December 31		
	Note	2006	2005
NIS in thousands (see note 1b.)			
<b>Liabilities and shareholders' equity</b>			
<b>CURRENT LIABILITIES:</b>	8		
Credit from banks and others	10c	203,003	93,171
Current maturities of long-term notes and long-term loans	4a;b	41,567	6,827
Accounts payable and accruals:	10d		
Trade		96,273	90,512
Dividend payable			50,093
Other		103,699	85,407
		<u>444,542</u>	<u>326,010</u>
<b>T o t a l current liabilities</b>			
<b>LONG-TERM LIABILITIES:</b>			
Deferred income taxes	7f	41,613	45,783
Loans and other liabilities (net of current maturities):	4;8		
Loans from banks	4b	33,515	
Notes	4a	190,005	227,811
Other liabilities	4c	32,770	32,770
		<u>297,903</u>	<u>306,364</u>
<b>T o t a l long-term liabilities</b>			
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>	9		
<b>T o t a l liabilities</b>		<u>742,445</u>	<u>632,374</u>
<b>SHAREHOLDERS' EQUITY:</b>	6		
Share capital (ordinary shares of NIS 0.01 par value: authorized - 20,000,000 shares; issued and paid: December 31, 2006 and 2005 - 4,032,723 and 4,002,205 shares, respectively)		125,257	125,257
Capital surplus		90,060	90,060
Capital surplus resulting from tax benefit on exercise of employee options		2,414	401
Differences from translation of foreign currency financial statements of associated companies		(8,341)	(813)
Retained earnings		221,452	308,479
		<u>430,842</u>	<u>523,384</u>
<b>T o t a l liabilities and shareholders' equity</b>		<u>1,173,287</u>	<u>1,155,758</u>

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

## AMERICAN ISRAELI PAPER MILLS LTD.

## CONSOLIDATED STATEMENTS OF INCOME

	Note	2006	2005	2004
NIS in thousands (see note 1b.)				
<b>SALES</b>	10e; 14	530,109	482,461	482,854
<b>COST OF SALES</b>	10f	418,725	383,179	375,904
<b>GROSS PROFIT</b>		111,384	99,282	106,950
<b>SELLING, MARKETING, ADMINISTRATIVE AND GENERAL EXPENSES:</b>	10g			
Selling and marketing		31,366	30,482	30,595
Administrative and general		29,517	*25,462	*21,917
		60,883	55,944	52,512
<b>INCOME FROM ORDINARY OPERATIONS</b>		50,501	43,338	54,438
<b>FINANCIAL EXPENSES - net</b>	10h	31,111	12,490	13,118
<b>OTHER INCOME (EXPENSES) - net</b>	10i	37,305	*4,444	*(508)
<b>INCOME BEFORE TAXES ON INCOME</b>		56,695	35,292	40,812
<b>TAXES ON INCOME (EXPENSES) - net</b>	7	16,720	5,991	3,152
<b>INCOME FROM OPERATIONS OF THE COMPANY AND ITS SUBSIDIARIES</b>		39,993	29,301	37,660
<b>SHARE IN PROFITS (LOSSES) OF ASSOCIATED COMPANIES - net</b>	2	(26,202)	16,414	25,072
<b>INCOME BEFORE CUMULATIVE EFFECT, AT BEGINNING OF YEAR, OF AN ACCOUNTING CHANGE IN ASSOCIATED COMPANIES</b>		13,791	45,715	62,732
<b>CUMULATIVE EFFECT, AT BEGINNING OF YEAR, OF AN ACCOUNTING CHANGE IN AN ASSOCIATED COMPANY</b>	1k	(461)		
<b>NET INCOME FOR THE YEAR</b>		13,330	45,715	62,732
(See Note 1b) NIS				
<b>EARNINGS PER SHARE:</b>	1r;11			
<b>Primary:</b>				
Before cumulative effect of a change in accounting policy		3.42	11.43*	15.77**
Cumulative effect, at beginning of year, of a change in accounting policy at loss of an associated company		(0.11)		
Net income per share		3.31	11.43*	15.77**
<b>Fully diluted:</b>				
Before cumulative effect of a change in accounting policy		3.39	11.35*	15.44**
Cumulative effect, at beginning of year, of a change in				

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	<u>Note</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
accounting policy at loss of an associated company		(0.11)		
Net income per share		3.28	11.35*	15.44**
Number of shares used to compute the primary earnings per share		4,025,181	3,999,867	3,978,936
Number of shares used to compute the fully diluted earnings per share		4,058,610	4,028,107	4,061,671

\* Reclassified

\*\* As a result of implementing retroactively the change of accounting policy

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

## AMERICAN ISRAELI PAPER MILLS LIMITED

## STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Share capital	Capital surpluses	Capital surplus resulting from tax benefit on exercise of employee options	Differences from currency translation resulting from financial statements of associated companies	Retained earnings	Total
NIS in thousands (see note 1b.)						
<b>BALANCE AT JANUARY 1, 2004</b>	125,257	90,060		(1,122)	400,035	614,230
<b>CHANGES IN 2004:</b>						
Net income					62,732	62,732
Dividend paid					(99,964)	(99,964)
Exercise of employee options into shares	*					*
Differences from currency translation resulting from financial statements of associated companies				(1,685)		(1,685)
<b>BALANCE AT DECEMBER 31, 2004</b>	125,257	90,060		(2,807)	362,803	575,313
<b>CHANGES IN 2005:</b>						
Net income					45,715	45,715
Dividend paid ***					(100,039)	(100,039)
Exercise of employee options into shares	*		401			401
Differences from currency translation resulting from financial statements of associated companies				1,994		1,994
<b>BALANCE AT DECEMBER 31, 2005</b>	125,257	90,060	401	(813)	**308,479	523,384
<b>CHANGES IN 2006:</b>						
Net income					13,330	13,330
Dividend paid					(100,357)	(100,357)
Exercise of employee options into shares	*		2,013			2,013
Differences from currency translation resulting from financial statements of associated companies				(7,528)		(7,528)
<b>BALANCE AT DECEMBER 31, 2006</b>	125,257	90,060	2,414	(8,341)	221,452	430,842

\* Represents an amount less than NIS 1,000.

\*\* See note 2c.

\*\*\* Includes a dividend, declared in December 2005 and paid in January 2006, amounting to approximately NIS 50 million.

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

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>NIS in thousands (see note 1b)</b>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income for the year	13,330	45,715	62,732
Adjustments to reconcile net income to net cash provided by operating activities (A)	39,775	42,845	(15,637)
Net cash provided by operating activities	<u>53,105</u>	<u>88,560</u>	<u>47,095</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of fixed assets	(53,107)	(71,080)	(30,952)
Deposit and Marketable securities	11,582	51,003	(42,000)
Associated companies:			
Granting of loans		(2,744)	(779)
Collection of loans	2,112		13,688
Proceeds from sale of subsidiary consolidated in the past (B)		2,004	
Proceeds from sale of fixed assets	419	6,532	1,001
Net cash used in investing activities	<u>(38,994)</u>	<u>(14,285)</u>	<u>(59,042)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Receipt of long-term loans from others	40,000	1,746	
Repayment of long-term loans from banks	(1,277)	(277)	(383)
Redemption of notes	(6,913)	(6,680)	(6,666)
Dividend paid	(150,450)	(49,946)	(99,964)
Short-term credit from banks - net	109,832	(18,613)	(31,933)
Net cash used in financing activities	<u>(8,808)</u>	<u>(73,770)</u>	<u>(138,946)</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>5,303</b>	<b>505</b>	<b>(150,893)</b>
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>8,318</b>	<b>7,813</b>	<b>158,706</b>
<b>BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b><u>13,621</u></b>	<b><u>8,318</u></b>	<b><u>7,813</u></b>

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



**AMERICAN ISRAELI PAPER MILLS LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<u>NIS in thousands (see note 1b.)</u>		
<b>(A) Adjustments to reconcile net income to net cash provided</b>			
<b>by operating activities:</b>			
Income and expenses not involving cash flows:			
Share in losses (profits) of associated companies - net	26,663	(16,414)	(25,072)
Dividend received from associated company	19,616	21,761	
Depreciation and amortization	31,957	31,604	28,633
Deferred income taxes - net	(5,755)	(7,671)	(10,096)
Capital losses (gains) on:			
Sale of fixed assets - net	(28,823)	(3,570)	508
Sale of subsidiary consolidated in the past (B)		(874)	
Losses (gains) on short-term deposits and investments	(166)	45	(464)
Linkage and exchange differences (erosion) on principal of long-term loans from banks - net		(111)	(26)
Linkage differences (erosion) on principal of notes	(415)	6,171	2,184
Linkage differences (erosion) on principal of long-term loans granted to associated companies	178	(975)	(721)
	<u>43,255</u>	<u>29,966</u>	<u>(5,054)</u>
Changes in operating asset and liability items:			
Increase in trade receivables	(17,641)	(7,162)	(2,279)
Increase in other receivables (excluding deferred income taxes)	(1,661)	(1,587)	(12,037)
Decrease (increase) in inventories	1,890	(1,612)	7,434
Increase in trade payables	5,761	3,018	2,954
Increase (decrease) in other payables and accruals	8,171	20,222	(6,655)
	<u>(3,480)</u>	<u>12,879</u>	<u>(10,583)</u>
	<u>39,775</u>	<u>42,845</u>	<u>(15,637)</u>
<b>Supplementary disclosure of cash flow information</b>			
<b>Payments in cash during the year:</b>			
Income taxes paid	23,877	1,559	3,242
Interest paid	23,714	15,828	20,697

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

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>2005</b>
	<b>NIS in thousands (see note 1b)</b>
<b>(B) Proceeds from sale of subsidiary consolidated in the past -</b>	
see also note 10h:	
Assets and liabilities of the subsidiary consolidated in the past at the date of its sale:	509
Working capital (excluding cash and cash equivalents)	1,979
Fixed assets	(1,358)
Long-term liabilities	874
	2,004
Capital gain from the sale	2,004

**(C) Information on activities not involving cash flows:**

- 1) Dividend declared by the Company in December 2005, in the amount of approximately NIS 50 million, was paid in January 2006.
- 2) Dividend declared by an associated company in December 2005 that the Company's share in this dividend amounts to NIS 2,650,000 was paid during 2006.
- 3) In 2004, equipment, which the Company had found to be unsuitable for its use, was retired. The retirement was made against the cancellation of the loan made available by the supplier in respect of said equipment. The retirement amounted to NIS 1,079,000.
- 4) In December 2006 a land was sold in consideration of approximately NIS 40 million, net of tax, betterment levy and other accompanying selling cost. This amount was transferred to a trustee at the date of the transaction execution and received during January 2007 see note 10i.

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

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES**

The financial statements are drawn up in conformity with accounting principles generally accepted in Israel and in accordance with the Israeli Securities (Preparation of Annual Financial Statements) Regulations, 1993. The Company's financial statements are presented separately from these consolidated financial statements. The significant accounting policies, which, except for the changes in the accounting policy concerning revenue recognition, in an associated company, and after taking into consideration, by way of retrospective application, the change in accounting policy concerning the computation of net income per share, resulting from the first-time application, in 2006, of new accounting standards of the Israel Accounting Standards Board (hereafter - the IASB) and first-time application of clarification no. 7 in 2005, were applied on a consistent basis, as follows:

As to the adoption of International Financial Reporting Standards (IFRS), which is to be carried out in reporting periods commencing on January 1, 2008 and thereafter, see s. below.

**a. General:**

1) Activities of the Group

American Israeli Paper Mills Limited and its subsidiaries (hereafter the Company) are engaged in the production and sale of paper packaging, in paper recycling activities and in the marketing of office supplies. The Company also has holdings in associated companies that are engaged in the production and sale of paper and paper products including the handling of solid waste (the Company and its investee companies hereafter the Group). Most of the Group's sales are made on the local (Israeli) market. For segment information, see note 14.

2) Use of estimates in the preparation of financial statements

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

3) Definitions:

Subsidiaries companies over which the Company has control and over 50% of the ownership, the financial statements of which have been consolidated with the financial statements of the Company.

Associated companies investee companies, which are not subsidiaries, over whose financial and operational policy the Company exerts material influence, the investment in which is presented by the equity method. Material influence is deemed to exist when the percentage of holding in said company is 20% or more, unless there are circumstances that contradict this assumption.

Interested parties as defined in the Israeli Securities (Preparation of Annual Financial Statements) Regulations, 1993.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

**b. Basis of presentation of the financial statements**

The Company draws up and presents its financial statements in Israeli currency (hereafter - shekels or NIS), in accordance with the provisions of Israel Accounting Standard No. 12 Discontinuance of Adjusting Financial Statements for Inflation of the IASB, which establishes principles for transition to nominal reporting, commencing January 1, 2004 (hereafter - the transition date). Accordingly, amounts that relate to non-monetary assets (including depreciation and amortization thereon), investments in associated companies (see also below) permanent investments, and equity items, which originate from the period that preceded the transition date, are based on the data adjusted for the changes in the exchange rate of the dollar (based on the exchange rate of the dollar at December 31, 2003), as previously reported. All the amounts originating from the period after the transition date are included in the financial statements at their nominal values.

The financial statements of group companies which are drawn up in foreign currency, are translated into shekels or are remeasured in shekels for the purpose of inclusion in these financial statements, as explained in e. below.

The sums of non-monetary assets do not necessarily reflect the realization value or an updated economic value, but rather only the reported sums of the said assets, as stated in (1), above. The term cost in these financial statements shall mean the cost in reported sums.

**c. Principles of consolidation:**

- 1) The consolidated financial statements include the accounts of the Company and its subsidiaries. A list of the main subsidiaries is presented in a schedule to the financial statements.
- 2) Intercompany transactions and balances, as well as profits on intercompany sales that have not yet been realized outside the Group, have been eliminated.

**d. Inventories**

Raw materials and supplies, finished goods, purchased products and maintenance and sundry materials (including spare parts) are valued at the lower of cost or market (net of processing costs and after deduction of a provision for obsolescence, where appropriate); cost is determined on the moving average basis. Spare parts of the machinery and equipment that are not for current use, are presented under fixed assets.

**e. Investments in associated companies:**

- 1) The investments in these companies are accounted for by the equity method. According to this method, the Company records, in its statement of income, its share in the profits and losses of these companies that were created after acquisition, and, in its statement of changes in shareholders' equity, its share in changes in capital surpluses (mostly translation differences relating to their investments in subsidiaries that present their financial statements in foreign currency) that were created after acquisition.
- 2) Profits on intercompany sales, not yet realized outside the Group, have been eliminated according to the percentage of the Company's holding in such companies.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

- 3) The Company reviews at each balance sheet date whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of its investments in associated companies see h. below.
- 4) The excess of cost of the investment in associated companies over the equity in net assets at time of acquisition ( excess of cost of investment ) or the excess of equity in net assets of associated companies at time of acquisition over the cost of their acquisition ( negative excess of cost of investment ) represent the amounts attributed to specific assets upon acquisition, at fair value. The excess of cost of investment and the negative excess of cost of investment are presented at their net amount and are amortized over the remaining useful life of the assets. The average rate of amortization is 10%.
- 5) In accordance with the provisions of Standard No. 20 (As Amended), which is applied by the group companies since January 1, 2006, as of that date, amortization of goodwill at associated company, which until then was included under share in profits (losses) of associated companies , was discontinued. The amounts of amortization of goodwill, included under share in profits (losses) of associated companies , as above, for the years ended December 31, 2005 and 2004 are NIS 4 million and NIS 4 million, respectively.

**f. Marketable securities**

These securities are stated at market prices.

The changes in value of the above securities are carried to financial income or expense.

**g. Fixed assets:**

- 1) Fixed assets are stated at cost, net of related investment grants.
- 2) Fixed assets of own manufacture are stated at cost, based on the direct costs with the addition of an appropriate portion of indirect production costs.
- 3) Borrowing costs in respect of credit applied to finance the construction of fixed assets - during the period until construction is completed - are charged to the cost of such assets.
- 4) The assets are depreciated by the straight-line method on the basis of their estimated useful life, as follows:

	<u>Years</u>
Buildings	10-50 (mainly 33)
Machinery and equipment	7-20 (mainly 10 and 20)
Vehicles	5-7 (mainly 7)
Office furniture and equipment	3-17 (mainly 4)

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

- 5) As to the change in the accounting treatment of property, plant and equipment, commencing January 1, 2007, resulting from the application of Israel Accounting Standard No. 27 of the IASB, Property, Plant and Equipment - see s(3) below.
- 6) As to the change in the accounting treatment of investment property, commencing January 1, 2007, resulting from the application of Israel Accounting Standard No. 16 of the IASB, Investment Property - see s(5) below.

**h. Impairment of assets**

The Company assesses at each balance sheet date whether any events have occurred or changes in circumstances have taken place, which might indicate that there has been an impairment of non-monetary assets, mainly fixed assets and investments in associated companies. When such indicators of impairment are present, the Company evaluates whether the carrying value of the asset is recoverable from the cash flows expected from that asset. See note 2g.

The recoverable value of an asset is determined according to the higher of the net selling price of the asset or its value in use to the Company. The value in use is determined according to the present value of anticipated cash flows from the continued use of the asset, including those expected at the time of its future retirement and disposal.

When it is not possible to assess whether an impairment provision is required for a particular asset on its own, the need for such a provision is assessed in relation to the recoverable value of the cash-generating unit to which that asset belongs.

**i. Deferred charges**

The item represents notes issuance costs, which are amortized over the period of the notes (see note 4a).

As to the change from January 1, 2006 in the method of presenting and amortizing these charges - see o(2) below.

**j. Deferred income taxes:**

- 1) Commencing January 1, 2005, the Company applies the IASB's Accounting Standard No. 19 Taxes on Income that prescribes the accounting treatment (recognition criteria, measurement, presentation and disclosure) required for taxes on income.

For the most part, the provisions of this standard are the same as the accounting principles that the Company applied prior to implementing the new standard.

- 2) In accordance with the standard and with prior years' policy, the Company recognizes deferred taxes in respect of temporary differences between the amounts of assets and liabilities as reported in the consolidated financial statements and those taken into account for tax purposes; the standard requires that full recognition be given to deferred taxes in

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

respect of all taxable temporary differences, except for the temporary difference resulting from the initial recognition of goodwill and the temporary difference resulting from the initial recognition of an asset or a liability that has no effect on the profit or loss, whether for accounting or tax purposes, at that time (unless the temporary difference results from the initial recognition of a business combination).

Deferred tax assets are recognized for all temporary differences that are tax deductible, up to the amount of the differences that are expected to be utilized in the future, against taxable income. As to the main types of differences, in respect of which deferred taxes have been included see note 7f.

- 3) Deferred tax balances are computed at the tax rates expected to be in effect at the time the deferred tax asset is utilized or the deferred tax liability is settled, based on the tax rates and the tax laws enacted, or substantively enacted, by the balance sheet date.
- 4) The current taxes, as well as the changes in the deferred tax balances, are included in the tax expenses or income in the reporting period.
- 5) Taxes that would apply in the event of disposal of investments in subsidiaries and associated companies have not been taken into account in computing the deferred taxes, as it is the Company's policy to hold these investments, not to realize them.
- 6) The Group may incur an additional tax liability in the event of an intercompany dividend distribution derived from approved enterprises' profits see note 7a. No account was taken of this additional tax, since it is the Group's policy not to cause distribution of dividends, which would involve an additional tax liability to the Group in the foreseeable future.
- 7) In April 2005, the IASB issued Clarification No. 7 Accounting Treatment of the Tax Benefits, in Respect of Capital Instruments Granted to Employees, For Which No Compensation was Recognized. The provisions of this clarification apply to such tax benefits, which have not been allowed as a deduction through December 31, 2004. The clarification stipulates that, commencing on January 1, 2005, the tax benefit derived by the Company from the exercise of options granted to employees is to be carried to shareholders' equity, in the period in which the benefit to the employees is allowed as a deduction for tax purposes. Formerly, the aforesaid tax saving was credited to the statement of income, as part of the taxes on income item.

**k. Revenue recognition**

Commencing January 1, 2006, the company applies Israel Accounting Standard No. 25 of the IASB Revenue, which prescribes recognition, measurement, presentation and disclosure criteria for revenues originating from the sale of goods purchased or manufactured by the company.

Revenue is measured, as detailed below, at the fair value of the consideration received or the consideration that the company is entitled to receive, taking into account trade discounts and/or bulk discounts granted by the entity:

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

Revenue from sale of goods is recognized when all the following conditions have been satisfied: (a) the significant risks and rewards of ownership of the goods have been transferred to the buyer; (b) the company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the company; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Upon the application of the standard, an associated company separates the financing component embedded in revenue from sales made on credit for periods exceeding the customary credit period in its industry (mainly 90 days), that does not bear interest at the appropriate rate; the financing component is determined according to the amount by which the nominal amount of consideration for the transaction exceeds the present value of future cash payments in respect thereof, based on the customary market interest rate applicable to credit extended under similar terms. Revenue from the financing component is recognized over the credit period. Through December 31, 2005, the company did not separate the financing component in respect of sales made on credit, as above, and included within revenue from the sale on the date of recognition of such revenue. In accordance with the transitional provisions of the standard, on January 1, 2006 the company recognized an expense of NIS 1.1 million as a result of presentation in present value, resulting from the adjustment of trade receivables in respect of such credit transactions to their present value on the effective date of the standard, the share of the company at the adjustment effect as above was approximately NIS 0.5 million which is presented in these financial statements under Cumulative effect, at beginning of year, of an accounting change .

**l. Shipping and handling costs**

Shipping and handling costs are classified as a component of selling and marketing expenses.

**m. Allowance for doubtful accounts**

The allowance is determined mainly in respect of specific debts doubtful of collection (see note 12b).

**n. Derivate financial instruments**

Gains and losses on derivatives that are hedging existing assets or liabilities are recognized in income commensurate with the results from those assets or liabilities.

**o. Financial instruments**

Commencing January 1, 2006, the Company applies Israel Accounting Standard No. 22 of the IASB Financial Instruments: Disclosure and Presentation (hereafter - Standard 22), which prescribes the rules for presentation of financial instruments and the proper disclosure required therefore, as follows:



**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

1) **Offset of financial instruments**

Financial assets and financial liabilities are presented on the balance sheet at their net amount, only when the Company has a legally enforceable right to effect such set off, and subject to the existence of intent to settle the asset and the liability on a net basis, or to realize the asset and settle the liability simultaneously.

2) In accordance with the transitional provisions of Standard 22, commencing January 1, 2006, in addition to the aforesaid, the financial statements include the following changes:

The balance of deferred issuance costs, which at December 31, 2005 amounted to NIS 946 thousands, has been reclassified and presented as a deduction from the amount of the liabilities to which such expenses relate. Through December 31, 2005, deferred issuance costs were included under other assets and amortized according to the straight-line method.

The change in the amortization method of deferred issuance costs, as above, do not have a material effect on the operating results in the reported years.

**p. Share-based payment**

Commencing January 1, 2006, the company applies Israel Accounting Standard No. 24 of the IASB, Share-Based Payment (hereafter - Standard 24), which prescribes the recognition and measurement principles, as well as the disclosure requirements, relating to share-based payment transactions.

Since the company has not granted any equity-settled awards, nor made modifications to existing grants, subsequent to March 15, 2005, the measurement criteria of the standard do not apply to past grants made by the company, and its application has not had any effect on the comparative figures included in these financial statements.

**q. Cash equivalents**

The Company considers all highly liquid investments, which include short-term bank deposits that are not restricted as to withdrawal or use, the period to maturity of which did not exceed three months at time of deposit, to be cash equivalents.

**r. Net income per share**

Commencing January 1, 2006, the company applies the provisions of Israel Accounting Standard No. 21 of the IASB, Earnings per Share. The computation of basic net income per share is generally based on earnings available for distribution to holders of ordinary shares, divided by the weighted average number of ordinary shares outstanding during the period.

In computing diluted net income per share, the weighted average number of shares to be issued, assuming that all dilutive potential shares are converted into shares, is to be added to the average number of ordinary shares used in the computation of the basic income (loss) per share. Potential shares are taken into account, as above, only when their effect is dilutive (reducing net income per share from continuing activities).

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

Comparative net income per share figures included in these financial statements reflect a retrospective application of the new standard's computation directives.

As to the data used in the computation of net income per share, as above - see note 11

**s. Recently issued accounting pronouncements in Israel**

**1) Israel Accounting Standard No. 29 Adoption of International Reporting Financial Standards (IFRS)"**

In July 2006, the Israel Accounting Standards Board issued Israel Accounting Standard No. 29 Adoption of International Reporting Financial Standards (IFRS) (hereafter - Standard 29). Standard 29 stipulates that companies, which are subject to the Securities Law, 1968 and are required to report pursuant to regulations issued thereunder, shall draw up their financial statements under International Financial Reporting Standards (IFRS) with effect from reporting periods commencing on January 1, 2008 (i.e. commencing the financial statements for the first quarter of 2008). Pursuant to the provisions of Standard 29, such companies and other companies may elect early adoption of the Standard, and prepare their financial statements under IFRS, commencing with the financial statements that are published subsequent to July 31, 2006.

The standard prescribes that companies, which currently do not draw up their financial statements under IFRS, and are required or elect, as stated above, to prepare their financial statements for the first time under IFRS, shall apply the provisions specified in International Financial Reporting Standard No. 1 (IFRS 1) - First-Time Adoption of International Financial Reporting Standards in making the transition. IFRS 1, which deals with first-time transition to reporting under IFRS, provides that, in the first annual financial statements that are drawn up under IFRS (including the interim financial statements for that year), all the latest IFRS standards in effect at the end of the reporting year in which the company reports under IFRS for the first time, shall be applied retrospectively (with the exception of certain exemptions and prohibitions, as referred to below). IFRS 1 specifies two groups of exceptions to the principle of retrospective application: (1) exemptions from mandatory retrospective application with regard to certain topics, while providing the option to utilize all or part of those exemptions, and (2) prohibitions concerning mandatory retrospective application with regard to defined topics. Pursuant to the provisions of IFRS 1, the first financial statements drawn up under IFRS shall include at least one year's comparative data. Accordingly, a company that draws up its financial statements under IFRS for the first time for periods commencing after January 1, 2008, and elects to present comparative data for one year only, shall be required, pursuant to IFRS 1, to prepare an opening balance sheet as of January 1, 2007, which shall be drawn up under IFRS. In preparing this opening balance sheet, all the latest IFRS standards, as referred to above, with regard to recognition, non-recognition, classification and measurement of all the company's assets, liabilities and shareholders' equity items, shall be applied. IFRS 1 also establishes certain disclosure requirements that apply to the annual financial statements that are drawn up for the first time under IFRS. Pursuant to these disclosure requirements, companies applying IFRS for the first time are required to explain what effect the transition from the previous generally accepted accounting principles to IFRS has had on the reported financial position, operating results and cash flows. Also, companies are required to include notes providing reconciliations of the data reported under the previous accounting principles, to the data reported under IFRS, in respect of their shareholders' equity and statements of income (loss) as of certain dates and for certain prior periods.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

In addition, Standard 29 requires companies, which draw up their financial statements under IFRS for the first time for periods commencing after January 1, 2008, to disclose, in a note to their financial statements for 2007, the balance sheet data as of December 31, 2007 and income statement data for the year ended December 31, 2007, as they would appear after applying IFRS recognition, measurement and presentation rules.

IFRS differ from general accounting principles accepted in Israel and, accordingly, financial statements drawn up under IFRS might reflect a financial position, operating results and cash flows that are significantly different from those presented in these financial statements. Application of IFRS requires a proper arrangement from the company, including making certain decisions relating to the manner of determining assets and liabilities at the transition date and with regard to setting an accounting policy for various topics. The company is currently assessing the implications of the transition to reporting under IFRS, including the date for first-time adoption of IFRS by the company. At this stage, the company is unable to estimate the effect that the adoption of IFRS will have on its financial statements.

**2) Israel Accounting Standard No. 26 Inventory**

In August 2006, the IASB issued Israel Accounting Standard No. 26 - Inventory , which is based on International Accounting Standard No. 2. This standard prescribes the accounting treatment of inventory and provides guidelines for determining the cost of inventory and its subsequent recognition as an expense, including recognition and treatment of any write-down to net realizable value.

The standard specifies the costs that are to be taken into account in determining the cost of inventory and the costs that may not be included in the cost of inventory, and requires that fixed production overheads be allocated based on the normal capacity of the production facilities.

In determining the cost of inventory, the standard requires specific identification of the cost of certain items that are not ordinarily interchangeable and of goods and services that have been produced and segregated for specific projects. In other instances, the standard prescribes the exclusive use of the first-in, first-out (FIFO) method or the weighted average method.

The standard also stipulates that the financing element in purchases of inventory on credit must be accounted for separately, whenever the actual arrangement includes a financing element. For instance, the difference between the purchase price on normal credit terms and the actual amount paid is to be recognized as interest expense over the financing period.

This standard shall be applicable to financial statements for periods commencing on or after January 1, 2007. The standard is to be applied retrospectively, unless it is impracticable to determine the specific effects in a given period.

At this stage the Company is examining the possible effect of the standard on its financial statements.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

**3) Israel Accounting Standard No. 27 Property, Plant and Equipment**

In September 2006, the IASB issued Israel Accounting Standard No. 27 - Property, Plant and Equipment, which is based on International Accounting Standard No. 16. This standard prescribes the accounting treatment for property, plant and equipment. The standard stipulates provisions for the recognition of an item of property, plant and equipment as an asset, the initial measurement of its cost, the measurement subsequent to initial recognition, as well as provisions regarding depreciation and derecognition of an item of property, plant and equipment.

According to the standard, an item of property, plant and equipment that qualifies for recognition as an asset is to be measured at cost upon its initial recognition. The standard determines that the cost of an item of property, plant and equipment includes its purchase price (including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates), 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, as well as the initial estimate of the present value of the costs of dismantling and removing the item and restoring the site on which it is located (if the entity is obligated to do so). According to the standard, the cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. Accordingly, if payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit.

Subsequent to the date of initial recognition, the standard allows for a choice between the cost method and the revaluation method as an accounting policy, which must be applied to all the items within a given class of property, plant and equipment. Under the cost method, an item of property, plant and equipment shall be carried at its cost, less any accumulated depreciation and any accumulated impairment losses. Under the revaluation method, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

An increase in the carrying amount of an item of property, plant and equipment, resulting from a revaluation, is to be credited directly to equity under the heading of Revaluation surplus. However, such increase shall be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

On the other hand, a decrease in the carrying amount of an item of property, plant and equipment, resulting from a revaluation, is to be recognized in profit or loss. However, the decrease shall be debited directly to equity under the heading of Revaluation surplus, to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

The standard discusses the definition of a depreciable amount of an item of property, plant and equipment, its residual value and the period and method of depreciation. The standard stipulates that, for the purpose of depreciating property, plant and equipment, the amount initially recognized in respect of an item of property, plant and equipment should be allocated to its significant parts, and each such part should be depreciated separately. Nevertheless, different parts of an item of property, plant and equipment, with the same useful life and depreciation method, may be grouped for the purpose of depreciation.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

According to the provisions of the standard, the residual value, the useful life and the depreciation method of an asset should be reviewed at least at each fiscal year-end; if there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the depreciation method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate.

The standard is to be applied to financial statements for periods commencing on or after January 1, 2007, by way of retrospective application, with two exceptions. First, for a company that, upon the adoption of the standard, chooses the revaluation method as its accounting policy, the difference between the revalued amount of the asset and its carrying amount as of January 1, 2007 shall represent the revaluation surplus as of the said date. Second, if the initial cost of the asset does not include any removal and disposal costs, specific transitional provisions stipulated in the standard should be applied.

The Company is currently examining the effect of the application of the standard on the financial statements.

Recently, the IASB issued standard proposal No. 28 correction of transitional provisions stipulated in standard No. 27 and adjusting them to the IFRS1.

**4) Israeli Accounting Standard No. 23 Accounting Treatment Applied to Transactions between an Entity and its Controlling Shareholder .**

In December 2006, the IASB issued Accounting Standard No. 23 Accounting Treatment Applied to Transactions between an Entity and its Controlling Shareholder .

The standard, which does not obligate entities that are not subject to the Securities Law, 1968, provides that assets and liabilities, in respect of which a transaction was carried out between an entity and its controlling shareholder, shall be measured at the date of transaction at their fair value, and the difference between fair value and the consideration set in the transaction shall be carried to shareholders' equity. Those provisions replace the requirements of the Securities Regulations (Presentation of Transactions between an Entity and its Controlling Shareholder in Financial Statements), 1996, whereunder, assets transferred as above would be measured at their carrying amount in the transferor's accounts, while the difference between this value and the consideration set in those transactions is carried to shareholders' equity.

Under the provisions of the standard, in case the difference between fair value and the consideration arises from a benefit granted by the controlling shareholder to the entity controlled thereby, the said difference shall be credited to capital surplus within the entity's shareholders' equity; while in case the said difference arises from a benefit granted by the entity to its controlling shareholder, such difference shall be carried to the entity's retained earnings.

In addition, the difference between the fair value of the asset and its carrying amount in the transferor's accounts shall be recognized as a gain or loss in the transferor's accounts. Under the standard, differences as above, arising in the financial statements of an entity as a result of a transaction with its controlling shareholder, and carried to retained earnings or capital surplus, shall constitute, from the controlling shareholder's point of view, an owner's withdrawal or an owner's investment, respectively, and shall be presented accordingly in the financial statements of the controlling shareholder.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

The standard includes specific provisions pertaining to assets transfers, assuming liabilities, indemnification and waiver and the grant or receipt of loans. The standard also sets a hierarchy for the measurement of fair value and includes disclosure requirements as to the nature and scope of transactions between an entity and its controlling shareholder, occurring during the reported period, as well as to the effect of these transactions on the entity's income or loss for the reported period and its financial position.

The standard shall apply to all transactions taking place between an entity and its controlling shareholder, except for a business combination under common control, that would be carried out subsequent to January 1, 2007. In addition, the standard would apply to a loan granted to a controlling shareholder or received therefrom, prior to the abovementioned effective date of the standard; the standard would apply to such a loan commencing the standard's effective date.

At this stage the Company is examining the possible effect of the standard on its financial statements.

**5) Israel Accounting Standard No. 16 Investment Property**

In February 2007, the IASB issued Israel Accounting Standard No. 16 - Investment Property, which is based on International Accounting Standard No. 40. This standard prescribes the accounting treatment applicable to investment property. The standard sets provisions for the recognition, measurement and disclosure required for investment property in the financial statements.

According to the standard, investment property is property held to earn rentals or for capital appreciation or both, rather than for: (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business.

The standard stipulates that investment property, which qualifies as an asset, is to be measured at cost upon its initial recognition. According to the standard, the cost of an investment property comprises its purchase price and other directly attributable expenditures (such as fees for legal services, transfer taxes and other transaction costs).

Subsequent to the date of initial recognition, the standard allows a choice between the cost model and the fair value model as an accounting policy, which must be applied to all investment property items of the entity. According to the standard, transition from one model to the other is only allowed if such transition results in a more appropriate presentation in the financial statements. The standard states that this is not highly likely to be the case when transition is from the fair value model to the cost model.

Under the cost model, the entity shall account for investment property in accordance with the cost model specified in Standard 27 - Property, Plant and Equipment, pursuant to which the investment property is to be carried at depreciated cost (net of accumulated impairment losses).

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES** (continued):

According to the fair value model, subsequent to initial recognition, the entity shall measure all of its investment property at fair value as of the balance sheet date. Gains or losses resulting from changes in fair value are carried to the statement of income (loss) in the period in which they arise. In exceptional cases, when fair value cannot be reliably determinable for certain investment property items, and the entity has elected the fair value model as an accounting policy for its investment property, such specific items shall be accounted for using the cost model, despite the application of the fair value model to the other investment property items.

The standard includes extensive disclosure requirements, including, inter alia, disclosure as to the fair value of the investment property, if the company has opted for the cost model.

This standard shall be applicable to financial statements for periods commencing on January 1, 2007 or thereafter. Election of the fair value model would require the adjustment of the opening balance of retained earnings for the period in which the standard is first adopted.

At this stage, the Company is examining the effect of the application of the standard on the financial statements.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 2 INVESTMENTS IN ASSOCIATED COMPANIES:**

a. The Company has a number of investments in associated companies, which are held either directly or through investee companies. The financial statements of significant associated companies (Mondy Business Paper Hadera Ltd. formerly Neusiedler Hadera Paper Ltd, NHP and Hogla-Kimberly Ltd.) are attached to these financial statements.

b. Composed as follows:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
	<b>NIS in thousands</b>	
Shares:		
Cost	54,241	54,241
Excess of cost of investment - net	2,086	2,086
Less - accumulated amortization	(2,086)	(2,180)
Gain on issuance of shares of an associated company to a third party	40,241	40,241
Differences from translation of foreign currency financial statements	(8,341)	(813)
Share in profits (after deduction of losses) accumulated since acquisition	219,328	263,051
	305,469	356,626
Long-term loans and capital notes *	70,041	72,331
	375,510	428,957

\* Classified by linkage terms and rate of interest, the total amounts of the loans and capital notes are as follows:

	<b>Weighted average interest rate at December 31, 2006</b>	<b>December 31</b>	
		<b>2006</b>	<b>2005</b>
	<b>%</b>	<b>NIS in thousands</b>	
In dollars		6,337	9,206
Unlinked loans and capital notes	4.8%	63,704	63,125
		70,041	72,331

As of December 31, 2006, the repayment dates of the balance of the loans and capital notes have not yet been determined.



**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 2 INVESTMENTS IN ASSOCIATED COMPANIES** (continued):**c. The changes in the investments during 2006 are as follows:**

	<b>NIS in thousands</b>
Balance at the beginning of the year	*428,957
Changes during the year:	
Share in losses of associated companies - net	(26,663)
Dividend from associated companies	(16,966)
Adjustments resulting from translation of foreign currency financial statements	(7,528)
Increase in balance of long-term loans and capital notes - net	(2,290)
Balance at end of year	375,510

\* In the first quarter of the year, the balance of negative goodwill as of January 1, 2006 amounted NIS 1,062 thousands, was written off against retained earnings. In these financial statements this reporting entry was cancelled since the amount represented a negative excess of cost of investment.

**d. Mondy Business Paper Hadera Ltd.** (hereafter - Mondy Hadera; formerly Neusiedler Hadera Paper Ltd. NHP):

Mondy Hadera is held to the extent of 49.9% by the Company and also by Mondy Business Paper LTD (hereafter - MBP), under an agreement dated November 21, 1999. According to said agreement, Mondy Hadera purchased the Group's activities in the field of printing and writing paper, and issued to MBP 50.1% of its shares. As part of the said agreement, Neusiedler was granted an option to sell to the Company its holdings in Mondy Hadera, at a price that is 20% lower than the value (as defined in the agreement). The understanding between the parties is that the option would only be exercised under prolonged, extraordinary circumstances that preclude the operation of Mondy Hadera in Israel. The Company believes that the likelihood of such circumstances is very remote.

**e. Hogla-Kimberly Ltd.** (hereafter - Hogla-Kimberly)

Hogla-Kimberly is held to the extent of 49.9% by the Company and to the extent of 50.1% by Kimberly Clark Corporation (hereafter- KC).

**f. Investment in Carmel Container Systems Limited** (hereafter - Carmel)

Carmel Container Systems is held to the extent of 26.25% by the Company. In November 2004, Carmel's board of directors decided to take measures to withdraw Carmel's shares from trade on the AMEX Stock Exchange in the United States and also to deregister with the SEC. Accordingly, trade in Carmel's shares on the AMEX was suspended from November 30, 2004 and in July 2005 the process of deregistering the shares from being traded and with the SEC was finalized.

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**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 2 INVESTMENTS IN ASSOCIATED COMPANIES (continued):**

**g. Investment in T.M.M Integrated Recycling Industries Ltd.** (hereafter T.M.M.)

As of December 31, 2006, the Company's share in T.M.M. (directly and through another associated company) is 43.08%

T.M.M. announced in March 2006 that the Securities Authority was conducting an unspecified investigation in its matter. T.M.M. possesses no information regarding the investigation. To date, the Company's management cannot estimate the impact of the above matter, if any, on the Company and on its financial statements. As a result of the implementation of Accounting Standard No. 15, T.M.M. recorded a loss of NIS 12.5 million from the impairment of fixed assets in the third quarter of 2006, based on the estimate of an external assessor. The Company's share in this loss (43.08%) amounts to NIS 5.4 million. This sum appears as part of the Company's share in the earnings (losses) of associated companies this year.

On January 4, 2007, the Company entered into an agreement with Veolia Israel CGEA Ltd. (hereinafter: CGEA), whereby it will sell to CGEA its holdings in Barthelemi, along with its remaining holdings in T.M.M. Pursuant to the agreement, CGEA has acquired all of the Company's holdings in Barthelemi. CGEA also acquired all of the Company's holdings in T.M.M., as part of a complete tender offer and starting February 2007, the Company is no longer a shareholder in T.M.M.

The sale of the holdings in T.M.M. was made in consideration of a sum approximately similar to the book value, after taking into account, the impairment as mention above.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 3 FIXED ASSETS:**

- a. Composition of assets and the accumulated depreciation thereon, grouped by major classifications, and changes therein during 2006, are as follows:

	Cost			Accumulated depreciation				Depreciated balance December 31		
	Balance at beginning of year	Additions during the year	Retirements during the year	Balance at end of year	Balance at beginning of year	Additions during the year	Retirements during the year	Balance at end of year	2006	2005
	NIS in thousands			NIS in thousands				NIS in thousands		
Land and buildings thereon	228,822	414	489	228,747	110,804	3,471	331	113,944	114,803	118,018
Machinery and equipment	689,398	12,838	30	702,206	488,956	23,099	11	512,044	190,162	200,442
Vehicles	31,096	5,205	962	35,339	20,915	3,055	921	23,049	12,290	10,181
Office furniture and equipment (including computers)	70,166	1,045	298	70,913	57,302	2,332	255	59,379	11,534	12,864
Payments on account of machinery and equipment, net	15,167	34,162		49,329					49,329	15,167
Spare parts - not current, net	23,262	(557)		22,705					22,705	23,262
	<u>1,057,911</u>	<u>53,107</u>	<u>1,779</u>	<u>1,109,239</u>	<u>677,977</u>	<u>31,957</u>	<u>1,518</u>	<u>708,416</u>	<u>400,823</u>	<u>379,934</u>

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 3 FIXED ASSETS (continued):**

- b. The item is net of investment grants in respect of investments in approved enterprises (see notes 7a and 9a).
- c. The Company's real estate is partly owned and partly leased to the extent of NIS 43.8 million, in respect of which lease fees of approximately NIS 25.8 million have been capitalized. The leasehold rights are for 49 year periods ending in the years 2008 to 2059, with options to extend for an additional 49 years.
- d. As of December 31, 2006 and 2005, the cost of fixed assets includes borrowing costs of NIS 1,007,000 capitalized to the cost of machinery and equipment.
- e. Depreciation expenses amounted to NIS 31,957,000 NIS 31,444,000 and NIS 28,472,000, for the years ended December 31, 2006, 2005 and 2004, respectively.
- f. As to pledges on assets see note 9a.
- g. As to the change in accounting treatment of property, plant and equipment, which will take effect commencing January 1, 2007, as a result of applying Accounting Standard No. 27, Property, Plant and Equipment of the IASB see note 1s (3).
- h. As to the change in accounting treatment of investment property, commencing January 1, 2007, as a result of applying Accounting Standard No. 16 Investment Property of the IASB see note 1s (5).

**NOTE 4 NOTES AND OTHER LONG-TERM LIABILITIES:****a. Notes**

The item represents two series of notes issued to institutional investors as follows:

	December 31			
	2006		2005	
	NIS in Thousands			
	Series II	Series I	Series II	Series I
Balance	206,627	20,522	207,229	27,409
Less - current maturities	29,518	6,841		6,827
	177,109	13,681	207,229	20,582

## 1) Series I May 1992

The balance of the notes as of December 31, 2005 is redeemable in four installments, due in June of each of the years 2006-2009, each installment amounting to 6.66% of the original par value of the notes, which is NIS 102,202,000, in December 2006 terms; the unpaid balance of the notes bears annual interest of 3.8%, payable annually each June. The notes' principal and interest are linked to the Israeli CPI of February 1992.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 4 NOTES AND OTHER LONG-TERM LIABILITIES:**

## 2) Series II December 2003

The balance of the notes as of December 31, 2005 is redeemable in 7 equal, annual installments due in December of each of the years 2007-2013; the unpaid balance of the notes bears annual interest of 5.65%, payable annually each December. The notes principal and interest are linked to the Israeli CPI of November 2003.

## 3) As to the change from January 2006 in the presentation of deferred issuance costs see note 1i above.

**b. Long-Term Loans**

The section refers to two long-term loans that were received from banks, as detailed below:

	<b>December 31, 2006 NIS Thousands</b>
Loan 1	14,319
Loan 2	24,404
Less - current maturities	5,208
	33,515

## 1) Loan 1

In July 2006, the Company assumed a loan of NIS 15 million. The outstanding balance as at December 31, 2006, is scheduled for repayment in 21 quarterly installments through to January 2012, each in the sum of NIS 0.7 million. The outstanding balance of the loan carries a variable rate of interest, linked to the Prime lending rate.

## 2) Loan 2

In July 2006, the Company assumed a loan of NIS 25 million. The outstanding balance as at December 31, 2006, is scheduled for repayment in 31 quarterly installments through to July 2014, each in the sum of NIS 1.0 million including principal and interest component on the outstanding balance of principal. The outstanding balance of the loan carries a variable rate of interest, linked to the Prime lending rate.

**c. Other liability:**

The capital note from an associated company is unlinked and interest free. No repayment date has been fixed, but the associated company does not intend to demand the repayment of the capital note before January 1, 2008.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 5 EMPLOYEE RIGHTS UPON RETIREMENT:**

- a. Israeli labor laws and agreements require the Company and its subsidiaries to pay severance pay to employees dismissed or leaving their employ under certain circumstances, computed on the basis of the number of years of service, or a pension upon retirement.

To cover the liability for employee rights upon retirement, pursuant to labor agreements in force and based on salary components that, in management's opinion, create entitlement to severance pay, deposits are made by the Company and its subsidiaries with various provident funds (including pension funds) or insurance policies for the benefit of the employees.

The severance pay and pension liability and the amounts funded as above are not reflected in the financial statements, as the pension and severance pay risks have been irrevocably transferred to the pension funds and the insurance companies, as allowed by the Severance Pay Law.

- b. The expenses relating to employee rights upon retirement, which reflect the amounts that were deposited during the reported years with provident funds, pension funds and various insurance policies, are NIS 8,849,000, NIS 8,710,000, and NIS 8,368,000 in 2006, 2005, and 2004, respectively.

**NOTE 6 SHAREHOLDERS EQUITY:****a. Share capital**

Composed of ordinary registered shares of NIS 0.01 par value, as follows:

	<b>Authorized</b>	<b>December 31</b>	
		<b>2006</b>	<b>2005</b>
	<b>Authorized</b>	<b>Issued and paid</b>	
Number of shares	20,000,000	4,032,723	4,002,205
Amount in NIS	200,000	40,327	40,022

The shares are traded on stock exchanges in Tel-Aviv and in the U.S. ( AMEX ). The quoted prices per share, as of December 31, 2006 are NIS 182.9 and \$ 45.70 (NIS 193.08), respectively.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 6 SHAREHOLDERS EQUITY (continued):**

**b. Employee stock option plans:**

1) The 2001 plan for senior officers in the Group

On April 2, 2001, the Company's board of directors approved a stock option plan for senior officers in the Group (hereafter - the 2001 plan for senior officers). Under this plan, 194,300 options were allotted on July 5, 2001 without consideration. Each option can be exercised to purchase one ordinary share of NIS 0.01 par value of the Company. The options are exercisable in four equal annual batches. The blocking period of the first batch is two years, commencing on the date of grant; the blocking period of the second batch is three years from the date of grant, and so forth. Each batch is exercisable within two years from the end of the blocking period.

The exercise price of the options granted as above was set at NIS 217.00, linked to the CPI, on the basis of the known CPI on April 2, 2001. The exercise price for each batch is determined as the lesser of the aforementioned exercise price or the average price of the Company's shares as quoted on the Tel-Aviv Stock Exchange (hereafter - the Stock Exchange) during the thirty trading days preceding to the effective date of each batch, less 10%. As stipulated by the 2001 plan for senior officers, the exercise price of unexercised options is to be adjusted, in the event of cash dividend distributions. Accordingly, the exercise price as of December 31, 2006 is batch, NIS 78.66 for the third batch and NIS 132.09 for the fourth batch. In July 2005, the remaining options from the first batch expired and in July 2006, the remaining options from the second batch expired.

The quoted price of the Company's shares on the Tel Aviv Stock Exchange, immediately prior to the date of the board of directors' resolution to grant the options, was NIS 204.00. Immediately prior to the granting of the options, the price was NIS 185.8.

The fair value of each option - computed on the basis of the Black-Scholes option-pricing model - as prescribed by the regulations of the Tel-Aviv Stock Exchange - was approximately NIS 56.69 on the date of grant.

Notwithstanding the above, the number of shares resulting from the exercise of the options and the actual exercise price will be determined as follows: Upon receipt of an exercise request from an option holder, a computation will be made of the difference between the quoted price of the Company's shares at the beginning of that trading day and the exercise price; that difference is to be multiplied by the number of exercisable options (hereafter - the benefit). The number of shares that the Company will actually issue to the option holder will be the number of shares the market value of which is equal to the amount of the benefit computed as above. In consideration for the shares, the option holder will pay their par value only.

Immediately upon issuance, the ordinary shares issued upon exercise of the options will have all the same rights as other ordinary shares of the Company.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 6 SHAREHOLDERS EQUITY (continued):**

In 2006, 2005 and 2004, 44,998, 13,877 and 55,525 options, respectively, were exercised under the 2001 plan for senior officers, and 24,303, 4,307 and 24,295 shares of NIS 0.01, respectively, were issued following the exercise of the options, as above. 8,250 options expired in 2005 (from the first batch) and 10,225 options expired in 2006 (from the second batch). In 2006, 12,225 options were cancelled from the third batch and 12,225 were cancelled from the fourth batch. As of December 31, 2006, the unexercised balance of the options granted is 35,425. During 2007, after the balance sheet date, 10,321 options were exercised under the 2001 plan for senior officers, and 3,696 shares were issued.

This plan is designed to be governed by the terms stipulated by Section 102 of the Israeli Income Tax Ordinance. Inter alia, these terms provide that the Company is allowed to claim, as an expense for tax purposes, the amounts credited to the employees as a benefit in respect of shares or options granted under the plan.

The amount allowed as an expense for tax purposes, at the time the employee utilizes such benefit, is limited to the amount of the benefit that is liable to tax as labor income, in the hands of the employee; all being subject to the restrictions specified in Section 102 of the Income Tax Ordinance.

Since, in accordance with Israeli accounting principles, the Company does not recognize the expense in its accounts (with respect to the salary benefit embodied in these grants), then under Clarification No. 7 of the IASB (See note 1j(7)), the Company credited the tax saving derived from the exercise of benefits by employees in the years 2005-2006 to capital surplus.

2) The 2001 employee plan

On August 29, 2001, the Company's board of directors approved a stock option plan for employees in the Group, according to a specification (hereafter the 2001 employee plan). Under this plan, up to 125,000 options will be allotted without consideration. Each option can be exercised to purchase one ordinary share of NIS 0.01 par value of the Company. The blocking period of the options is two years from the date of grant. Each option is exercisable within three years from the end of the blocking period.

On November 4, 2001, 81,455 options were granted under the 2001 employee plan.

The exercise price of all the options granted as above was set at NIS 160.99, linked to the CPI, on the basis of the known CPI on August 29, 2001. This price represents the average price of the Company's shares as quoted on the Tel-Aviv Stock Exchange during the thirty trading days prior to the date of the board of directors' approval, less 10%. The 2001 employee Plan was expired during November 2006.

In 2006, 2005 and 2004, 10,091, 2,405 and 8,615 options, respectively, were exercised under the 2001 employee plan, and 6,215, 1,224 and 4,084 shares of NIS 0.01, respectively, were issued following the exercise of options, as above. The last of the options that were granted and were not exercised, expired during 2006.



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**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 6 SHAREHOLDERS EQUITY** (continued):

This plan is designed to be governed by the terms stipulated by Section 102 of the Israeli Income Tax Ordinance. Inter alia, these terms provide that the Company is allowed to claim, as an expense for tax purposes, the amounts credited to the employees as a benefit in respect of shares or options granted under the plan.

The amount allowed as an expense for tax purposes, at the time the employee utilizes such benefit, is limited to the amount of the benefit that is liable to tax as labor income, in the hands of the employee; all being subject to the restrictions specified in Section 102 of the Income Tax Ordinance.

Since, in accordance with Israeli accounting principles, the Company does not recognize the expense in its accounts (with respect to the salary benefit embodied in these grants), then under Clarification No. 7 of the IASB (See note 1j(7)), the Company credited the tax saving derived from the exercise of benefits by employees in 2005 to capital surplus.

**NOTE 7 TAXES ON INCOME:**

**a. Tax benefits under the Law for the Encouragement of Capital Investments, 1959** (hereafter the law)

Under the law, by virtue of the approved enterprise status granted to certain of their production facilities, certain subsidiaries were entitled to various tax benefits (mainly reduced tax rates) until 2003.

During the period of benefits mainly 7 years commencing in the first year in which the companies earn taxable income from the approved enterprises, provided the maximum period to which it is restricted by law has not elapsed reduced tax rates or exemption from tax apply, as follows:

- 1) Corporate tax rate of 25%, instead of the regular tax rate (see d. below).
- 2) Tax exemption on income from certain approved enterprises in respect of which the companies have elected the alternative benefits (involving waiver of government guaranteed loans instead of the tax exemption); the length of the exemption period is 4 years, after which the income from these enterprises is taxable at the rate of 25% for 3 years.

The part of the taxable income, which is entitled to the tax benefits, is determined on the basis of the ratio of the turnover attributed to the approved enterprise to the total turnover of these companies, taking into account the ratio of the approved enterprise assets to total assets of these companies. The turnover that is attributed to the approved enterprise is generally computed on the basis of the ratio of the increase in turnover to the basic turnover stipulated in the instrument of approval.

The period of benefits in respect of the approved enterprises of these companies expired at the end of 2003.

The entitlement to the above benefits is conditional upon the companies fulfilling the conditions stipulated by the law, regulations published thereunder and the

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 TAXES ON INCOME** (continued):

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 the companies may be required to refund the amount of the benefits, in whole or in part, with the addition of CPI linkage differences and interest.

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

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

**c. The Law for the Encouragement of Industry (Taxation), 1969**

The Company and certain consolidated subsidiaries are industrial companies as defined by this law. These companies claimed depreciation at accelerated rates on equipment used in industrial activity as stipulated by regulations published under the inflationary adjustments law.

The Company also files consolidated tax returns with certain consolidated subsidiaries as permitted under this law.

**d. Tax rates applicable to income not derived from approved enterprises**

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

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

Capital gains (except for the real capital gain from the sale of marketable securities to which the regular tax rates will apply) are taxed at a reduced tax rate of 25% on capital gains that arose after January 1, 2003, and at the regular corporate tax rate on income that arose until that date.

**e. Carryforward tax losses**

Carryforward tax losses in subsidiary companies are NIS 24,036,000 and NIS 22,470,000 as of December 31, 2006 and 2005, respectively.

The Company examines on each balance sheet date the possibility of recording deferred taxes in respect of carryforward tax losses based on an assessment of all evidence, both positive and negative, regarding the likelihood of their being taxable income in the foreseeable future. Under the inflationary adjustments law, carryforward losses are linked to the Israeli CPI, and may be utilized indefinitely.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 TAXES ON INCOME** (continued):**f. Deferred income taxes**

The composition of the deferred taxes at balance sheet dates, and the changes therein during the years 2006 and 2005, are as follows:

In respect of balance sheet items							
		Provisions for employee rights					
Depreciable fixed assets	Inventories	Severance pay	Vacation and recreation pay	Doubtful accounts	In respect of carryforward tax losses (see above)	Total	
NIS in thousands							
Balance at January 1, 2005	52,562	4,038	601	(4,087)	(5,910)	(6,511)	40,693
Changes in 2005 - amounts carried to income	(6,779)	(1,487)	(75)	8	(52)	714	(7,671)
Balance at December 31, 2005	45,783	2,551	526	(4,079)	(5,962)	(5,797)	33,022
Changes in 2006 - amounts carried to income	(4,170)	(1,404)	26	36	450	(693)	(5,755)
Balance at December 31, 2006	41,613	1,147	552	(4,043)	(5,512)	(6,490)	27,267

The deferred taxes are computed at the rate of 25%-29%.

Deferred taxes are presented in the balance sheets as follows:

		December 31	
		2006	2005
NIS in thousands			
Among current assets	(7,856)	(7,106)	
Among long-term asset balances	(6,490)	(5,655)	
Among long-term liabilities	41,613	45,783	
Balance - liability - net	27,267	33,022	

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 TAXES ON INCOME** (continued):**g. Taxes on income included in the income statements:**

1) As follows:

	2006	2005	2004
	NIS in thousands		
For the reported year:			
Current	22,457	13,662	13,248
Deferred, see f. above:			
In respect of changes to tax rates, see d. above		(4,166)	(5,824)
In respect of the reporting period	(5,755)	(3,505)	(4,272)
	16,702	5,991	3,152

Current taxes in 2006 were computed at an average tax rate of 31%, 2005 - 34% and 2004- 35%, see (2) below.

2) Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the regular rate applicable to companies in Israel, as stated in d. above, and the actual tax expense:

	2006		2005		2004	
	%	NIS in thousands	%	NIS in thousands	%	NIS in thousands
Income before taxes on income, as reported in the statements of income	100.0	56,695	100.0	35,292	100.0	40,812
Theoretical tax on the above amount	31.0	17,575	34.0	11,999	35.0	14,284
Decrease in taxes resulting from computation of deferred taxes at a rate which is different from the theoretical rate	(2.1)	(1,196)	(0.9)	(324)	(4.3)	(1,762)
Decrease in taxes resulting from adjustment to deferred tax balances due to changes in tax rates, see d. above			(11.8)	(4,166)	(14.3)	(5,824)
Tax deduction in respect of options exercised by employees according to Section 102 of the Israeli Income Tax Ordinance (2006 and 2005 - see note 1j(7))					(10.3)	(4,221)
Other - net	0.6	323	(4.3)	(1,518)	1.6	675
Taxes on income for the reported year	29.5	16,702	17.0	5,991	7.7	3,152

**h. Tax assessments**

The Company and most of its subsidiaries have received final tax assessments through the year ended December 31, 2000.

At the end of 2006 assessments discussions for the years 2002- 2004 for the Company and most of its subsidiaries have begun with the tax authority. It is the managements opinion, at this stage based, on the course of the discussion, which were held so far, it does not seem that the assessments will have material effect on the financial reports.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 LINKAGE TERMS OF MONETARY BALANCES:****a. As follows:**

	December 31, 2006			December 31, 2005		
	In, or linked to, foreign currency (mainly dollar)	Linked to the Israeli CPI NIS in thousands	Unlinked	In, or linked to, foreign currency (mainly dollar)	Linked to the Israeli CPI NIS in thousands	Unlinked
	NIS in thousands			NIS in thousands		
Assets:						
Current assets:	8,573		5,048			
Cash and cash equivalents				5,740		2,578
Marketable securities						11,416
Receivables	59,849	244	243,049	55,307	167	189,912
Investments in associated companies - long-term loans and capital notes	6,337		63,704	9,206		63,125
	74,759	244	311,801	70,253	167	267,031
Liabilities:						
Current liabilities:						
Short-term credit from banks			203,003			93,171
Accounts payables and accruals	8,422		191,551	11,062	868	214,082
Long-term liabilities (including current maturities):						
Long -term loans			38,723			
Notes		226,364			234,638	
Other liability			32,770			32,770
	8,422	226,364	466,047	11,062	235,506	340,023

As to exposures relating to fluctuations in foreign currency exchange rates and the use of derivatives for hedging purposes see note 12a.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 LINKAGE TERMS OF MONETARY BALANCES** (continued):**b. Data regarding the exchange rate and the Israeli CPI:**

	<b>Exchange rate of one dollar</b>	<b>CPI*</b>
	<b>NIS</b>	<b>Points</b>
<b>At end of year:</b>		
2006	4.225	184.9
2005	4.603	185.0
2004	4.308	180.7
<b>Change in the year:</b>		
2006	(8.2)	-
2005	6.8	2.4
2004	(1.6)	1.2

\* Based on the index for the month ending on each balance sheet date, on the basis of 1993 average = 100.

**NOTE 9 COMMITMENTS, CONTINGENT LIABILITIES AND LIABILITIES SECURED BY PLEDGES:****a. In respect of investment grants**

Under the Law for the Encouragement of Capital Investments, 1959, certain subsidiaries and an associated company have received investment grants from the State of Israel. In the event of failure to comply with the terms attached to the receipt of the grants, the companies may be required to refund the amount of the grants, in whole or in part, with linkage differences and interest from the date of receipt thereof.

The abovementioned subsidiaries have registered floating charges on all their assets in favor of the State of Israel in order to secure compliance with the terms of the investment grants received. In respect of the grant received by the associated company, the Company has provided a guarantee, with another associated company, for the repayment of the grant. As of December 31, 2005, the grant was repaid in full, as agreed with the Investment Center.

- b.** The Company has provided guarantees of NIS 2,113,000 in favor of an associated company, in connection with the latter's participation in a tender. If the associated company does not win the tender, the guarantee will become null and void.
- c.** Subsidiaries provided guarantees to various entities, in connection with tenders, in the aggregate amount of approximately NIS 1,917,000.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 COMMITMENTS, CONTINGENT LIABILITIES AND LIABILITIES SECURED BY PLEDGES** (continued):

- d. On May 7, 2001, the Company's board of directors resolved to carry out a plan, which was approved by the shareholders meeting, to remunerate the Company's former chairman of the board of directors. According to the plan, remuneration will be granted, equal to the increase in the value of 50,000 shares of the Company in the period from May 7, 2001 (share price NIS 194.37, linked to the terms of the plan) to May 7, 2008. The remuneration will be spread over the period commencing two years from the resolution of the board of directors, until the end of seven years from said resolution or until the time of termination of duty in certain conditions, the earlier. Up to December 31 2006, all of the remuneration was exercised.
- e. In accordance with the Companies Law, 1999, the Company issued new letters of indemnity to its officers in 2004, pursuant to which the Company undertakes to indemnify the officers for any liability or expense, for which indemnification may be paid under the law, that may be incurred by the officers in connection with actions performed by them as part of their duties as officers in the Company, which are directly or indirectly related to the events specified in the addendum to the letters of indemnity, provided that the total amount of indemnification payable to the officers, shall not exceed 25% of the Company's shareholders' equity as per its latest financial statements published prior to the actual indemnification. The liability of officers in connection with the performance of their duties, as above, is partly covered by an insurance policy.
- f. The Company is preparing for the conversion of its energy-generation plant to using natural gas, instead of fuel oil. The transition is planned for the second half of 2007, subject to the arrival of the gas in Hadera.

In this capacity, the Company signed an agreement in London on July 29, 2005, with the Thetis Sea Group, for the purchase of natural gas. The gas that will be purchased is intended to fulfill the Company's requirements in the coming years, for the operation of the existing energy generation plants using cogeneration at the Hadera plant, when it will be converted for the use of natural gas, instead of the current use of fuel oil. The overall financial scope of the transaction totals \$ 40 million over the term of the agreement (5 years from the initial supply of gas, but no later than July 1, 2011).

In this capacity the Company also contracted with Alstom Power Boiler Service gmbh, a manufacturer of equipment in the energy industry, in an agreement worth approximately 1.74 million, for the purchase of the systems needed for the conversion and assistance with their installation at the plant in Hadera. Up to December 31, the remainder of the agreement was worth approximately 0.6 million.

- g. In November 2006, the Environmental Protection Ministry announced that, even though the company plant at Hadera has made considerable investments in sewage treatment and environmental protection issues, an investigation may be launched against it to review deviations from certain emission standards into the air. Based on the opinion of its legal advisors, the Company anticipates that the investigation will not materially impact its results of operations.
- h. In November 2003 an associated company Hogla Kimberly received a claim and a petition for the approval of a class action against the Company. According to the petition the Company has reduced the number of units of diapers in a package of its Huggies Freedom brand. The plaintiffs estimate the scope of the class action to be NIS 18 million. A court hearing took place in this petition, but a decision was not given.



**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 9 COMMITMENTS, CONTINGENT LIABILITIES AND LIABILITIES SECURED BY PLEDGES** (continued):

In August, 2006 a request for a class action claim was filed against an associated company Hogla-Kimberly Ltd. in the amount of NIS 47 million for reducing the number of diapers in the Titulim Premium brand Packages.

In December, 2006 a request for a class action claim was filed against an associated company Hogla-Kimberly Ltd in the amount of NIS 43 million for reducing the quantity of papers in the toilet paper Kleeneks premium Packages.

In January, 2007 a request for a class action claim was filed against the Company in the amount of NIS 28 million for reducing the number of Wet Wipes in the Titulim premium wet wipes Packages.

In regards to the class action claims mentioned above, based on the associated company's legal counsels' opinion, at this stage, the company is unable to estimate the result of these class action claims but, Hogla-Kimberly has good defense prospects and therefore Hogla Kimberly did not include in its financial statements any provisions for these claims.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:****Balance sheets:**

	Weighted average interest rate at December 31, 2006	December 31	
		2006	2005
NIS in thousands			
<b>a. Receivables:</b>			
1) Trade:			
Open accounts		152,944	136,792
Checks collectible		15,106	13,617
		<u>168,050</u>	<u>150,409</u>
The item is:			
Net of allowance for doubtful		16,791	16,914
		<u>36,967</u>	<u>31,504</u>
Includes associated companies		36,967	31,504
2) Other:			
Employees and employee institutions		2,451	3,155
Associated companies - current debt		72,467	84,096
Prepaid expenses		3,732	4,041
Advances to suppliers		2,617	3,235
Deferred income taxes, see note 7f		7,856	7,106
Proceeds from sale of land in (see note 10i)		51,936	
Sundry		5,625	4,491
		<u>146,684</u>	<u>106,124</u>
<b>b. Inventories:</b>			
For industrial activities:			
Finished goods		16,998	16,578
Raw materials and supplies		7,884	9,356
		<u>24,882</u>	<u>25,934</u>
For commercial activities - purchased products		14,348	15,683
		<u>39,230</u>	<u>41,617</u>
Maintenance and spare parts *		22,879	22,382
		<u>62,109</u>	<u>63,999</u>

\*Including inventories for the use of associated companies.

**Weighted  
average  
interest rate**

**December 31**

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**c. Credit from banks:**

Unlinked	5.7%	203,003	93,171
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**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):****d. Accounts payable and accruals other:**

		<b>December 31</b>	
		<b>2006</b>	<b>2005</b>
		<b>NIS in thousands</b>	
	1) Trade:		
	Open accounts	91,932	84,727
	Checks payable	4,341	5,785
		96,273	90,512
	2) Other:		
	Payroll and related expenses	42,553	44,587
	Institutions in respect of employees	15,775	11,855
	Income tax authority	19,824	15,655
	Customs and value added tax authorities	8,814	142
	Accrued interest	2,104	1,209
	Accrued expenses	14,100	9,201
	Sundry	529	2,758
		103,699	85,407

**Statements of income:**

		<b>2006</b>	<b>2005</b>	<b>2004</b>
		<b>NIS in thousands</b>		
	<b>e. Sales - net (1):</b>			
	Industrial operations (2)	404,030	364,539	363,489
	Commercial operations	126,079	117,922	119,365
		530,109	482,461	482,854
	(1) Including sales to associated companies	149,173	115,262	121,987
	(2) Including sales to export	47,886	43,356	42,232
	<b>f. Cost of sales:</b>			
	Industrial operations:			
	Materials consumed	85,617	80,740	83,533
	Payroll and related expenses	104,880	96,370	92,566
	Depreciation	27,886	27,396	24,537
	Other manufacturing costs	106,387	94,517	81,893
	Decrease (increase) in inventory of			

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finished goods	(420)	(4,894)	3,135
	<u>324,350</u>	<u>294,129</u>	<u>285,664</u>
Commercial operations - cost of products sold	94,375	89,050	90,240
	<u>418,725</u>	<u>383,179</u>	<u>375,904</u>
Including purchases from associated companies	39,900	37,747	26,646
	<u>39,900</u>	<u>37,747</u>	<u>26,646</u>

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**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):**

	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<u>NIS in thousands</u>		
<b>g. Selling, marketing, administrative and general expenses:</b>			
Selling and marketing:			
Payroll and related expenses	13,954	13,641	14,311
Packaging, transport and shipping	9,243	7,866	6,458
Commissions	2,121	2,699	2,467
Depreciation	1,331	1,145	1,159
Other	4,717	5,131	6,200
	<u>31,366</u>	<u>30,482</u>	<u>30,595</u>
Administrative and general:			
Payroll and related expenses	43,407	39,727	36,649
Office supplies, rent and maintenance	1,593	1,241	1,521
Professional fees	1,167	991	1,029
Depreciation	3,128	2,903	2,776
Doubtful accounts and bad debts	(122)	840	3,102
Other	7,022	*4,201	*1,227
	<u>56,195</u>	<u>49,903</u>	<u>46,304</u>
Less - rent and participation from associated companies	26,678	24,441	24,387
	<u>29,517</u>	<u>25,462</u>	<u>21,917</u>
<b>h. Financial expenses - net*:</b>			
<b>Expenses:</b>			
In respect of long-term loans	1,196		26
In respect of notes - including amortization of deferred charges and net of related hedges	17,013	16,516	15,188
In respect of increase in value of operating monetary balance-net	4,771		
In respect of short-term balances	11,590	3,559	6,547
	<u>34,570</u>	<u>20,075</u>	<u>21,761</u>
<b>Income:</b>			
In respect of long-term loans	579	*385	*314
In respect of increase in value of operating monetary balances		3,294	1,901
In respect of short-term balances	2,880	*3,906	*6,428
	<u>3,459</u>	<u>7,585</u>	<u>8,643</u>

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	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(31,111)	(12,490)	(13,118)
** Including financial income (expenses) in respect of loans to associated companies	2,280	*3,401	721
* Reclassified			

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**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):**i. Other income**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>NIS in thousands</b>			
Proceeds from sale of land	*40,641	874	
Capital gain from sale of fixed assets	317		(508)
Gains (losses) from sale of the operation in Switzerland	(3,653)	3,570	
	37,305	4,444	(508)

\*On December 31, 2006, the Company sold a land estate. As a result of this sale, the Company recorded a capital gain in the amount of approximately NIS 28.5 million, net of tax, betterment levy, and expenses related to the sale. The proceeds of the sale, in the amount of NIS 43 million, were deposited on December 31, 2006 with a trustee in order to secure the liabilities of the Company. At the beginning of January 2007, the balance in the amount of approximately NIS 30 million was received, and in during the course of February this balance was transferred from the trustee to the Company.

**NOTE 11 NET INCOME PER SHARE**

Following are data relating to the net income and the number of shares (including adjustments to such data) used for the purpose of computing the basic and fully diluted net income per ordinary share. (The data for the years 2005 and 2004 are after retroactive application of the provisions of Accounting Standard No. 21 of the IASB, see note 1r):

<b>Net income</b>			
<b>Year ended December 31</b>			
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>NIS in thousands</b>			
Net income for the period, as reported in the income statements, used in computation of basic net income per share	13,330	45,715	62,732
Total net income for the purpose of computing diluted income per share	13,330	45,715	62,732
<b>Number of shares</b>			
<b>Year ended December 31</b>			
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Weighted average number of shares used for computing the basic income per share			
Adjustment in respect of incremental shares arising from exercise of warrants	4,025,181	3,999,867	3,978,936
	33,429	28,240	82,735



	<b>Net income</b>		
	<b>Year ended December 31</b>		
	2019	2018	2017
Weighted average number of shares used for computing the diluted income per share	4,058,610	4,028,107	4,061,671

The number of shares used in the computation of net income per share reflects the weighted average number of shares issued during the year.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:****a. Derivative financial instruments**

The Company has limited involvement with derivative financial instruments. The Company uses these instruments as hedges. The Company utilizes derivatives, mainly forward exchange contracts, to protect its expected cash flows in respect of existing assets and liabilities denominated in currencies other than the functional currency of the Company or that are linked to the CPI. As the counter-parties to these derivatives are Israeli banks, the Company considers the inherent credit risks remote.

In December 2005, the Company entered into forward transactions for a period of one year, in order to hedge an amount of NIS 230 million against increases in the CPI, following the termination of the 2004 transaction that was finalized.

In December 2006, the Company entered into forward transactions for a period of one year, in order to hedge an amount of NIS 100 million against increases in the CPI, following the termination of the aforementioned transaction.

In January 2007, the Company entered into forward transactions for a period of one year, in order to hedge an amount of NIS 120 million against increases in the CPI, following the termination of the aforementioned transaction.

**b. Credit risks**

The Company and its subsidiaries' cash and cash equivalents as of December 31, 2006 and 2005 are deposited mainly with major banks. The Company and its subsidiaries consider the credit risks in respect of these balances to be remote.

Most of these companies' sales are made in Israel, to a large number of customers. The exposure to credit risks relating to trade receivables is limited due to the relatively large number of customers. The Group performs ongoing credit evaluations of its customers to determine the required amount of allowance for doubtful accounts. An appropriate allowance for doubtful accounts is included in the financial statements.

**c. Exchange rate risks**

Approximately half of the Company's sales are nominated in US dollars, while a substantial part of its expenditures and its liabilities are in NIS, and as a result, the Company has an exposure to the changes in the rate of exchange of the NIS against the US dollar. This exposure includes an economic exposure (resulting from the excess of receipts over payments, in foreign currency on linked to it) and reporting exposure (relating to the excess of dollar linked assets over liabilities).

The Company has trade receivables balances linked to the US dollar - see note 8(a).

**d. Fair value of financial instruments**

The following table specifies the carrying amount and fair value of financial instrument groups that are not presented in the financial statements at their value:

	<b>Carrying Amount</b>	<b>Fair Value</b>
	<b>December 31, 2006 NIS in thousands</b>	
<b>Financial assets</b>		
Long term loans and capital note	63,704	62,005
<b>Financial Liabilities</b>		
Notes - series 1*	20,522	20,183
Notes - series 2*	206,627	211,284

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	<b>Carrying Amount</b>	<b>Fair Value</b>
Other liability*	32,770	31,210
	259,919	262,677

\* The above carrying amounts are based on the computation of the present value of cash flows at interest rates applicable to similar characterized loans (in 2006 5%).

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 13 INTERESTED PARTIES TRANSACTIONS AND BALANCES:****a. Transactions:**

## 1) Income (expenses):

	2006	2005	2004
	NIS in thousands		
Sales	47,803	46,396	45,278
Costs and expenses	(20,175)	(13,997)	(9,247)
Financial expenses	(2,191)	(1,731)	(1,688)

The amounts presented above represent transactions that the Company carried out in the ordinary course of business with interested parties (companies which are held by the Company's principal shareholder), at terms and prices similar to those applicable to non-affiliated customers and suppliers.

## 2) Benefits to interested parties:

	2006	2005	2004
Payroll to interested parties employed by the Company - NIS in thousands	*8,094	*5,181	*3,300
Number of people to whom the benefits relate	2	2	2
Remuneration of directors who are not employed by the Company - NIS in thousands	504	485	528
Number of people to whom the benefits relate	11	12	13

\* In 2006 includes the payroll of CEO and of the former Chairman of the Board of Directors and, in addition a payment to the former chairman of the Board of directors as a result of exercise of a bonus according to a remuneration plan. In 2005 including the CEO and the former Chairman of the Board of Directors. 2005 includes a special bonus to the Chairman of the Board of Directors, in a sum of NIS 800,000, subject to the general meeting's approval. In 2004 a CEO was in position only part of the year.

3) At December 31, 2006, an interested party employed by the Company (the CEO) held 1,975 options under the 2001 plan for senior employees in the group (see note 6b(1)).

4) As to the plan for the remuneration of the Company's former chairman of the Board of Directors see note 9e.

**b. Balances with interested parties:**

December 31

	<u>2006</u>	<u>2005</u>
Accounts receivable - commercial operations*	18,825	12,225
Accounts payables and accruals	4,930	4,401
Notes	38,871	30,697

\*There were no significant changes in the balance during the year.

**NOTE 14 SEGMENT INFORMTION:**

**a.** Activities of the Company and its subsidiaries:

- 1) Manufacturing and marketing of packaging paper, including collection and recycling of paper waste. The manufacturing of paper relies mainly on paper waste as raw material.
- 2) Marketing of office supplies and paper, mainly to institutions.  
Most of the sales are on the local (Israeli) market and most of the assets are located in Israel.

**AMERICAN ISRAELI PAPER MILLS LIMITED**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 14 SEGMENT INFORMATION** (continued):**b. Business segment data:**

	Paper and recycling			Marketing of office supplies			T o t a l		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
NIS in thousands									
Sales - net(1)	408,045	368,884	367,391	122,064	113,577	115,463	530,109	482,461	482,854
Income (loss) from ordinary operations	50,359	44,218	59,004	142	(880)	(4,566)	50,501	43,338	54,438
Financial expenses, net							31,111	12,490	13,118
Other income							37,305	4,444	(508)
Income before taxes on income							56,695	35,292	40,812
Taxes on income							16,702	5,991	3,152
Income from operations of the Company and its subsidiaries							39,993	29,301	37,660
Share in profits of associated companies - net							(26,663)	16,414	25,072
Net income							13,330	45,715	62,732
Segment assets (at end of year)	574,319	536,965	494,194	56,663	57,377	56,707	630,982	594,342	550,901
Unallocated corporate assets (at end of year) (2)							542,305	561,416	610,975
Consolidated total assets (at end of year)							1,173,287	1,155,758	1,161,876
Segment liabilities (at end of year)	69,923	57,754	58,782	26,350	32,758	28,774	96,273	90,512	87,556
Unallocated corporate liabilities (at end of year)							646,172	541,862	499,007
Consolidated total liabilities (at end of year)							742,445	632,374	586,563
Depreciation and amortization	30,137	29,795	26,671	1,820	1,809	1,962	31,957	31,604	28,633

(1) Represents sales to external customers.

(2) Including investments in associated companies.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Details of Subsidiaries and Associated Companies At  
December 31, 2006**

	<b>Percentage of direct and indirect holding in shares conferring equity and voting rights</b>
	<b>%</b>
<b>Main subsidiaries:</b>	
Amnir Recycling Industries Limited	100.00
Graffiti Office Supplies and Paper Marketing Ltd.	100.00
Attar Marketing Office Supplies Ltd.	100.00
American Israeli Paper Mills Paper Industry (1995) Ltd.	100.00
<b>Main associated companies:</b>	
Hogla-Kimberly Ltd.	49.90
Subsidiaries of Hogla-Kimberly Ltd.:	
Hogla-Kimberly Marketing Limited	49.90
Molett Marketing Limited	49.90
Shikma For Personal Comfort Ltd.	49.90
Turketim Mallari Sanayi ve Ticaret A.S (KCTR)	49.90
Mondy Business Paper Hadera Ltd.	49.90
Subsidiary of Mondy Business Paper Hadera Ltd.:	
Mondy Business Paper Hadera Marketing Ltd.	49.90
Carmel Container Systems Limited	26.25
Frenkel C.D. Limited**	35.16
Barthelemi Holdings Ltd.	35.98
T.M.M. Integrated Recycling Industries Ltd.***	43.08

\* Not including dormant companies.

\*\* Frenkel C.D. Limited is partly held through Carmel Container Systems Limited (an associated company); the holding in voting shares of C.D. Packaging Systems Limited is 27.85%.

\*\*\* At the beginning of 2007 all the holding at T.M.M and Barthelmi were sold, from this date were desisted this companies as mentioned above to be an associated companies.



**MONDI BUSINESS PAPER HADERA LTD.**

**FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2006**

**MONDI BUSINESS PAPER HADERA LTD.**

**FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2006**

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**MONDI BUSINESS PAPER HADERA LTD.**  
**BALANCE SHEETS**  
**(Reported Amounts)**  
**(NIS in thousands)**

	Note	Consolidated		Company	
		As of December 31,		As of December 31,	
		2006	2005	2006	2005
<b>Current Assets</b>					
Cash and cash equivalents		15	-	-	-
Trade receivables	3	173,174	160,875	-	-
American Israeli Paper Mills Group, net		-	-	243,559	231,715
Other receivables	4	6,610	10,872	7,850	14,813
Inventories	5	112,043	116,859	74,854	90,454
		291,842	288,606	326,263	336,982
<b>Long-Term Investments</b>					
Investments in Subsidiaries	6	-	-	1,429	2,595
<b>Fixed Assets</b>					
Cost	7	211,243	202,469	206,805	197,880
Less - accumulated depreciation		53,882	43,132	50,303	39,796
		157,361	159,337	156,502	158,084
<b>Long -Term Assets</b>					
Goodwill	6B	3,177	3,177	-	-
		3,177	3,177	-	-
		452,380	451,120	484,194	497,661
<b>Current Liabilities</b>					
Short term bank credit		96,740	85,887	96,740	85,871
Current maturities of long-term bank loans	10	15,243	16,242	15,243	16,242
Capital notes to shareholders	11	6,337	18,412	6,337	18,412
Trade payables	8	108,007	102,984	72,458	75,367
American Israeli Paper Mills Group, net		62,807	69,854	-	-
Subsidiaries		-	-	133,834	148,844
Other payables and accrued expenses	9	20,884	20,202	17,220	15,386
		310,018	313,581	341,832	360,122
<b>Long-Term Liabilities</b>					
Long-term bank loans	10	33,869	21,807	33,869	21,807
Capital notes to shareholders	11	6,338	-	6,338	-
Deferred taxes	20	14,047	19,900	14,047	19,900
Accrued severance pay, net	12	46	51	46	51

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		Consolidated		Company	
		54,300	41,758	54,300	41,758
<b>Commitments and Contingent Liabilities</b>	13				
<b>Shareholders' Equity</b>					
Share capital	14	1	1	1	1
Premium		43,352	43,352	43,352	43,352
Retained earnings		44,709	52,428	44,709	52,428
		88,062	95,781	88,062	95,781
		452,380	451,120	484,194	497,661

/s/ D. Muhlgay

/s/ A. Solel

/s/ A. Brener

**D. Muhlgay**  
Financial Director

**A. Solel**  
Managing Director

**A. Brener**  
Vice-Chairman of the Board of Directors

Approval date of the financial statements: February 6, 2007.

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

**MONDI BUSINESS PAPER HADERA LTD.**  
**STATEMENTS OF OPERATIONS**  
(Reported amounts)  
(NIS in thousands)

	Note	Consolidated			Company		
		Year ended December 31,			Year ended December 31,		
		2006	2005	2004	2006	2005	2004
Net sales	15	711,545	663,338	686,094	534,214	462,177	482,698
Cost of sales	16	659,845	609,752	605,738	501,080	420,558	416,504
<b>Gross profit</b>		51,700	53,586	80,356	33,134	41,619	66,194
Selling expenses	17	44,506	45,268	46,135	27,852	35,924	34,606
General and administrative expenses	18	9,245	7,301	7,803	6,788	6,702	6,442
<b>Operating profit (loss)</b>		(2,051)	1,017	26,418	(1,506)	(1,007)	25,146
Financing expenses, net	19	(6,854)	(12,868)	(8,438)	(6,540)	(11,533)	(7,643)
Other income, net		37	65	100	-	-	47
<b>Income (loss) before income taxes</b>		(8,868)	(11,786)	18,080	(8,046)	(12,540)	17,550
tax benefits (Income taxes)	20	1,149	8,380	(818)	1,493	8,470	(359)
<b>Income (loss) after income taxes (tax benefits)</b>		(7,719)	(3,406)	17,262	(6,553)	(4,070)	17,191
Equity in net earnings (losses) of Subsidiaries		-	-	-	(1,166)	664	71
<b>Net income (loss) for the year</b>		(7,719)	(3,406)	17,262	(7,719)	(3,406)	17,262

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

## MONDI BUSINESS PAPER HADERA LTD.

**STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**  
 (Reported amounts)  
 (NIS in thousands)

	<u>Share capital</u>	<u>Premium</u>	<u>Retained earnings</u>	<u>Total</u>
<b>Balance - January 1, 2004</b>	1	43,352	38,572	81,925
<b>Changes during 2004:</b>				
Net income for the year	-	-	17,262	17,262
<b>Balance - December 31, 2004</b>	1	43,352	55,834	99,187
<b>Changes during 2005:</b>				
Loss for the year	-	-	(3,406)	(3,406)
<b>Balance - December 31, 2005</b>	1	43,352	52,428	95,781
<b>Changes during 2006:</b>				
Loss for the year	-	-	(7,719)	(7,719)
<b>Balance - December 31, 2006</b>	1	43,352	44,709	88,062

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

**MONDI BUSINESS PAPER HADERA LTD.**  
**STATEMENTS OF CASH FLOWS**  
(Reported amounts)  
(NIS in thousands)

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
<b>Cash flows - operating activities</b>						
Net income (loss) for the year	(7,719)	(3,406)	17,262	(7,719)	(3,406)	17,262
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities (Appendix A)	(2,667)	(29,625)	20,295	(2,698)	(28,359)	30,855
Net cash provided by (used in) operating activities	(10,386)	(33,031)	37,557	(10,417)	(31,765)	48,117
<b>Cash flows - investing activities</b>						
Acquisition of fixed assets	(8,414)	(51,323)	(16,235)	(8,414)	(51,323)	(16,235)
Proceeds from sale of fixed assets	189	248	197	189	184	93
Net cash used in investing activities	(8,225)	(51,075)	(16,038)	(8,225)	(51,139)	(16,142)
<b>Cash flows - financing activities</b>						
Short-term bank credit, net	10,853	87,004	-	10,869	86,990	-
Repayment of long-term bank loans	(16,002)	(13,702)	(15,265)	(16,002)	(13,702)	(15,265)
Proceeds of long-term bank loans	28,000	-	-	28,000	-	-
Repayment of long-term capital notes to shareholders	(4,225)	-	(27,128)	(4,225)	-	(27,128)
Net cash provided by (used in) financing activities	18,626	73,302	(42,393)	18,642	73,288	(42,393)
<b>Increase (decrease) in cash and cash equivalents</b>	15	(10,804)	(20,874)	-	(9,616)	(10,418)
<b>Cash and cash equivalents - beginning of year</b>	-	10,804	31,678	-	9,616	20,034
<b>Cash and cash equivalents - end of year</b>	15	-	10,804	-	-	9,616

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



**MONDI BUSINESS PAPER HADERA LTD.**  
**APPENDICES TO STATEMENTS OF CASH FLOWS**  
**(Reported amounts)**  
**(NIS in thousands)**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
<b>A. <u>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities</u></b>						
<b>Income and expenses items not involving cash flows:</b>						
Equity in net losses (earnings) of Subsidiaries	-	-	-	1,166	(664)	(71)
Depreciation and amortization	10,907	10,722	9,118	10,513	9,617	7,885
Deferred taxes, net	(1,330)	(8,470)	823	(1,501)	(8,470)	359
Decrease in liability for severance pay, net	(5)	(36)	(58)	(5)	(36)	(58)
Capital gain from sale of fixed assets	(37)	(65)	(100)	(37)	-	(47)
Effect of exchange rate and linkage differences of long-term bank loans and long-term loan to Subsidiary	(935)	(738)	(195)	(935)	(739)	(195)
Effect of exchange rate differences of long-term capital notes to shareholders	(1,512)	1,179	571	(1,512)	1,179	571
<b>Changes in assets and liabilities:</b>						
Increase in trade receivables	(12,299)	(3,060)	(10,067)	-	-	-
Decrease (increase) in other receivables	(261)	(345)	(932)	2,611	(3,165)	574
Decrease (increase) in inventories	4,816	(26,468)	(1,160)	15,600	(30,153)	2,349
Increase (decrease) in trade payables	4,354	(4,235)	(220)	(3,578)	8,907	9,721
Increase (decrease) in American Israeli Paper Mills Group, net	(7,047)	4,821	16,247	(11,844)	49,685	(39,448)
Increase (decrease) in Subsidiaries	-	-	-	(15,010)	(53,426)	48,966
Increase (decrease) in other payables and accrued expenses	682	(2,930)	6,268	(1,834)	(1,094)	249
	<u>(2,667)</u>	<u>(29,625)</u>	<u>20,295</u>	<u>(2,698)</u>	<u>(28,359)</u>	<u>30,855</u>
<b>B. <u>Non-cash activities</u></b>						
Acquisition of fixed assets on credit	669	3,342	784	669	3,342	784

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

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**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 DESCRIPTION OF BUSINESS AND GENERAL**

**A. Description of Business**

Mondi Business Paper Hadera Ltd. ( the Company ) was incorporated and commenced operations on January 1, 2000. The Company and its Subsidiaries are engaged in the production and marketing of paper, mainly in Israel.

The Company is presently owned by Neusiedler Holdings BV. ( NHBV or the Parent Company ) (50.1%) and American-Israeli Paper Mills Ltd. ( AIPM ) (49.9%).

The financial statements are prepared in accordance with the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

**B. Definitions:**

<b>The Company</b>	Mondi Business Paper Hadera Ltd.
<b>The Group</b>	the Company and its Subsidiaries, a list of which is presented in Note 6C.
<b>Subsidiaries</b>	companies in which the Company exercises over 50% ownership and control, directly or indirectly, and whose financial statements are fully consolidated with those of the Company.
<b>Related Parties</b>	as defined by Opinion No. 29 of the Institute of Certified Public Accountants in Israel.
<b>Interested Parties</b>	as defined in the Israeli Securities Regulations (Presentation of Financial Statements), 1993.
<b>Controlling Shareholder</b>	as defined in the Israeli Securities Regulations (Presentation of Transactions between a Corporation and its Controlling Shareholder in the Financial Statements), 1996.
<b>NIS</b>	New Israeli Shekel.
<b>CPI</b>	the Israeli consumer price index.
<b>Dollar</b>	the U.S. dollar.
<b>Euro</b>	the United European currency.
<b>Reported Amount</b>	see Note 2A(1) below.

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 DESCRIPTION OF BUSINESS AND GENERAL (cont.)**

**C. Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES**

The following are the principal accounting policies applied in the preparation of the financial statements in a manner consistent with previous years with the exception of the application of the provisions of Standard No. 20 (Revised) Accounting Treatment for Goodwill and Other Intangibles upon the Acquisition of an Investee

**A. Cessation of Financial Statement Adjustment and Change to Reporting in Reported Amounts Standard No. 12**

**(1) Definitions**

**Adjusted Amount** historical nominal amount adjusted for changes in the exchange rate of the U.S. dollar as of December 31, 2003, in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel.

**Reported Amount** Adjusted Amount plus amounts in nominal terms added subsequent to December 31, 2003, and less amounts subtracted after that date.

**(2) General**

In January 2004, Israeli Accounting Standard No. 12 *Cessation of Financial Statements Adjustment* came into effect. Following the initial implementation of Standard No. 12, commencing January 1, 2004, the Group ceased the presentation of its financial statements based on nominal historical cost adjusted for the changes in the exchange rate of the U.S. dollar in relation to the NIS. Effective with the interim financial statements as of March 31, 2004 and for the reporting periods thereafter, including the years ended December 31, 2004 and 2005, the Group's financial statements are prepared and presented in Reported Amounts.

Comparative figures included in these financial statements relating to the year ended December 31, 2003, are presented in Adjusted Amounts.

The amounts at which non-monetary items are presented in these financial statements do not necessarily represent their realization value or economic value, but solely their Reported Amount.

The Company's condensed financial statements in nominal values, on the basis of which the Company's financial statements in Reported amounts and Adjusted Amounts were prepared, are presented in Note 24.

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MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS

**NOTE 2**    **SIGNIFICANT ACCOUNTING POLICIES (cont.)**

A.    **Cessation of Financial Statement Adjustment and Change to Reporting in Reported Amounts Standard No. 12 (cont.)**

(3)    **Principles of Adjustment applicable for financial statements in reporting amounts**

a.    **Balance Sheet Items**

Non-monetary items (items whose balances reflect historical value at acquisition or upon establishment) are presented at their Adjusted Amounts as of December 31, 2003 plus additions and dispositions occurring subsequent to such date. Additions made subsequent to December 31, 2003 and dispositions of items added subsequent to such date, are presented at their historical nominal value. Dispositions of items added on or prior to December 31, 2003 are presented at their Adjusted Amount.

Monetary items (items whose balance sheet amount reflects their current value or realization value at the balance sheet date) are presented at their nominal value as of the balance sheet date.

Investments in Subsidiaries are presented based on the financial statements of these companies prepared in accordance with the guidance of Standard No. 12.

b.    **Statement of Operations Items**

Income and expenses reflecting transactions, and financial income and expenses, are presented at their nominal value.

Income and expenses deriving from non-monetary items (mainly depreciation, amortization and changes in inventory) were presented in a manner corresponding to the presentation of the related non-monetary balance sheet item, as illustrated above.

The Company's share in the results of Subsidiaries is determined based on the financial statements of these companies prepared in accordance with the guidance of Standard No. 12.

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2    SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**B.    Principles of Consolidation**

The consolidated financial statements include consolidation of the financial statements of all Subsidiaries. Material inter-company balances and transactions of and between Subsidiaries have been fully eliminated. The unallocated excess cost due to investment in an investee deriving from the difference between the fair value of the investee's identifiable assets (including intangible assets) over the fair value of its identifiable liabilities (after deferred taxes) at the acquisition date is goodwill, which has been depreciated by December 31, 2005 over about 4 years.

See note H below for the accounting for goodwill as of January 1, 2006.

**C.    Cash and Cash Equivalents**

Cash and cash equivalents include bank deposits, available for immediate withdrawal, as well as unrestricted short-term deposits with maturities of less than three months from the date of deposit.

**D.    Allowance for Doubtful Accounts**

The allowance for doubtful accounts is computed on the specific identification basis for accounts whose collectibility, on management's estimation, is uncertain.

**E.    Inventories**

Inventories are stated at the lower of cost or net realizable value. Cost is determined for raw materials, auxiliary materials and finished products on the basis of weighted moving average cost per unit.

**F.    Investments in Subsidiaries**

Investments in Subsidiaries are presented using the equity method. For amortization of goodwill included in an investment in a Subsidiary, see H below.

**G.    Fixed Assets**

Fixed assets are presented at cost, including interest and other capitalizable costs (capitalizable costs include only incremental direct costs that are identifiable with, and related to, the property and equipment and are incurred prior to its initial operation), less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method at rates considered adequate to depreciate the assets over their estimated useful lives. Amortization of leasehold improvements is computed over the shorter of the term of the lease, including any option period, where the Company intends to exercise such option, or their useful life.

The annual depreciation and amortization rates are:

	<u>%</u>
Leasehold improvements	10
Machinery and equipment	5-20 (mainly 5%)
Motor vehicles	15-20
Office furniture and equipment	7-33

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2    SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**G.    Fixed Assets (cont.)**

**Impairment of Long-Lived Assets**

Management reviews long-lived assets on a periodic basis, as well as when such a review is required based upon relevant circumstances, to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. According to the Israeli Accounting Standards Board's Standard No. 15, *Impairment of Assets*, an asset's recoverable value is the higher of the asset's net selling price and the asset's value in use, the latter being equal to the asset's discounted expected cash flows. If applicable, an impairment charge is recorded at the amount in which the carrying amount of the asset exceeds its recoverable value.

**H.    Other Assets-Goodwill**

As of January 1, 2006 the Company applies Standard No. 20 (revised) Accounting Treatment for Goodwill and Other Intangibles upon the Acquisition of an Investee (in this paragraph- the standard). By December 31, 2005 the Company had systematically amortized its goodwill deriving from the Acquisition of investees using the straight line method over periods of 10 years.

As of January 1, 2006 the Company applies the Standard.

In accordance with the standard, goodwill is the unallocated excess cost due to investment in an investee deriving from the difference between the fair value of the investee's identifiable assets (including intangible assets) over the fair value of its identifiable liabilities (after deferred taxes) at the acquisition date. Goodwill is no longer amortized in a systematic manner, but is examined for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired.

In case of a realization of an investment in a subsidiary the goodwill will be taken into consideration in determining the profit or loss from the realization.

**I.    Deferred Income Taxes**

The Group records deferred income taxes in respect of temporary differences between the carrying values of assets and liabilities in the financial statements and their values for tax purposes, including depreciation differences on leased property and fixed assets. The Group records deferred-tax assets in respect of temporary differences as well as in respect of carry-forward tax losses so long as it is probable that those assets will be realized. The deferred income taxes are computed by the tax rates expected to be in effect at realization, as they are known at the balance sheet date.

The computation of deferred income taxes has not taken into account taxes that would have been applicable in case of future realization of investments in Subsidiaries, since the Group does not contemplate such realization in the foreseeable future.

**J.    Revenue Recognition**

Revenues are recognized upon shipment, when title has been transferred and collectibility is reasonably assured. Revenues are presented net of discounts granted. The accrual for estimated discounts granted is computed according to the provisions stipulated in the agreements, and is recorded when revenues are recognized.

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2    SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**K.    Supplier Discounts**

Ongoing discounts granted by suppliers, as well as year end discounts, in respect of which no commitments to meet given targets are required by the Group, are included in the financial statements upon the execution of purchases that grant the Group said discounts. Supplier discounts contingent upon the Group's fulfillment of certain targets, such as meeting a minimal annual volume (in quantities or amount), or an increase in purchases over previous periods, are included in the financial statements in proportion to Group's purchases from suppliers during the reported period, which advance the Group towards the stated targets, only if it is expected that those targets will be reached and the discounts can reasonably be estimated. Management's estimate of meeting the targets is based, inter-alia, on historical experience, Group's relationships established with the suppliers and the estimated volume of purchases during the remaining reported period.

**L.    Exchange Rates and Linkage Basis**

- (1) Balances in foreign currency or linked thereto are included in the financial statements based on the representative exchange rates, as published by the Bank of Israel, that were prevailing at the balance sheet date.
- (2) Following are the changes in the representative exchange rate of the U.S. dollar vis-a-vis the NIS and in the Israeli CPI:

<b>As of:</b>	<b>Representative exchange rate of the Dollar (NIS per \$1)</b>	<b>CPI "in respect of" (in points)</b>
December 31, 2006	4.225	184.87
December 31, 2005	4.603	185.05
December 31, 2004	4.308	180.74
<b>Increase (decrease) during the year ended:</b>	<b>%</b>	<b>%</b>
December 31, 2006	(8.2)	-
December 31, 2005	6.8	2.4
December 31, 2004	(1.6)	1.2

- (3) Exchange-rate differences are charged to operations as incurred.



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MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS

**NOTE 2**    **SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**M.**    **Recent Accounting Standards**

**Standard No. 23**    *Accounting for Transactions between an Entity and a controlling party*

In December 2006 the Israeli Accounting Standards Board published Accounting Standard No. 23, Accounting for Transactions between an Entity and a controlling party (hereinafter the Standard). The Standard applies to entities subject to the Israeli Securities Law-1968.

The Standard establishes the requirements for accounting for transactions between an entity and its controlling party, which involve asset transfers, assumption of liability, reimbursement or debt concession, and receipt of loans. The Standard does not apply to business combinations between entities under common control.

The Standard stipulates that transactions between an entity and a controlling party will be measured based on fair value; transactions which in nature are owner investments or distributions to owners should be reported directly in equity and not be recognized in the controlled entity's profit and loss; the differences between the consideration in transactions between an entity and a controlling party and their fair value will be recognized directly in equity. Current and deferred taxes pertaining to the items recognized in equity due to transactions with controlling parties will be recognized directly in equity as well.

The Standard is effective for transactions between an entity and a controlling party taking place subsequent to January 1, 2007 and for loans granted from or given to a controlling party prior to the Standard's effective date, starting on the Standard's effective date.

The Company is currently examining this new standard, including the election between the cost and the revaluation methods; however, at this stage, it is unable to estimate the standard's effect, if any, on its financial position, results of operations and cash flows.

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MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS

**NOTE 2**    **SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**M.**    **Recent Accounting Standards (cont.)**

**Application of Standard No.26 *Inventory***

In August 2006 the Israeli Accounting Standards Board published Accounting Standard No. 26 - "Inventory" ("the Standard"), which outlines the accounting treatment of inventory.

The standard applies to all types of inventory, other than buildings constructed for sale and addressed by Accounting Standard No.2 ( Construction of Buildings for Sale ), inventory of work in progress stemming from performance contracts, addressed by Accounting Standard No.4 ( Work Based on Performance Contract ), financial instruments and biological assets relating to agricultural activity and agricultural production during harvest.

The standard establishes, among other things, that inventory should be stated at the lower between cost and net realizable value. Cost is determined by the first in, first out (FIFO) method or by average weighted cost used consistently for all types of inventory of similar nature and uses. In certain circumstances the standard requires cost determination by a specific identification of cost, which includes all purchase and production costs, as well as any other costs incurred in reaching the inventory's present stage.

When inventory is acquired on credit incorporating a financing component, the inventory should then be presented at cost equaling purchase cost in cash. The financing component is recognized as a financing expense over the term of the credit period.

Any reduction of inventory to net realizable value following impairment as well as any other inventory loss should be expensed in the current period.

Subsequent elimination of an impairment write-down that stems from an increase in net realizable value will be allocated to operations during the period in which the elimination took place. This standard will apply to financial statements covering periods beginning January 1, 2007 and onwards and be implemented retroactively.

Management believes that the standard will not affect the Company's financial position, results of operations and cash flows.

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2      SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**M.      Recent Accounting Standards (cont.)**

**Application of Standard No. 27 *Fixed Asset***

In September 2006 the Israeli Accounting Standards Board published Accounting Standard No. 27 ( *Fixed Assets* ), which establishes the accounting treatment of fixed assets, including recognition of assets, determination of their book value, related depreciation, losses from impairment as well as the disclosure required in the financial statements.

The standard states that a fixed-asset item will be measured at the initial recognition date based cost which includes, in addition to the purchase price, all the related costs incurred for bringing the item to the position enabling it to operate in the manner contemplated by management. The cost also includes the initial estimate of costs required to dismantle and remove the item, along with the expenses incurred in reconstructing the site on which the item had been placed and in respect of which the entity incurred that obligation when the item had been acquired or following its use over a given period of time not in the production of inventory during that period.

The standard also states that when acquiring assets in exchange for a non-monetary asset or a combination of monetary as well as non-monetary assets, the cost will be determined at fair value unless (a) the barter transaction has no commercial essence or (b) it is impossible to reliably measure the fair value of the asset received and the asset provided. Should the provided asset not be measured at fair value, its cost would equal book value.

Following the initial recognition, the standard permits the entity to implement in its accounting policy the measurement of the fixed assets by the cost method or by revaluation so long as this policy is implemented in regard to all the items in that Company.

Cost method    an item will be presented at net book value, less accumulated impairment losses.

Revaluation method    an item whose fair value can be measured reliably will be presented at its estimated amount, which equals its fair value at the revaluation date, net of depreciation accumulated subsequently and less accumulated impairment losses. Revaluations should take place on a current basis in order to ensure that book value does not materially differ from the fair value that would have been determined on the balance-sheet date. The revaluation of a single item calls for the revaluation of the entire Company and if the asset's book value rises following this revaluation, this increase should be allocated directly to shareholders' equity ( *revaluation reserve* ). Nevertheless, this increase will be recognized as an operating item up to the amount offsetting the decrease from that asset's revaluation recognized previously as income or loss. Should book value decline following revaluation, this decline will be recognized as an operating item yet allocated directly to shareholders' equity ( *revaluation reserve* ) up to the amount leaving any credit balance in that reserve in respect of that asset.

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MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS

**NOTE 2**    **SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**M.**    **Recent Accounting Standards (cont.)**

**Application of Standard No. 27 *Fixed Asset* (cont.)**

Any fixed asset with a meaningful cost in relation to the item's total cost should be depreciated separately. Moreover, the depreciation method used will be reviewed at least once at yearend and, if any meaningful change had taken place in the estimated consumption of future economic benefits inherent in the asset, the method should be modified to reflect such changes. This change will be treated as a change in an accounting estimate.

This new standard will apply to financial statements covering periods beginning January 1, 2007 and onwards and implemented retroactively, except for the following:

An entity which chooses on January 1, 2007 the revaluation method will treat the difference between the asset's estimated book value and its cost as a revaluation reserve at that time.

An entity which did not include in the cost of an item, upon initial recognition, the initial estimate of dismantling and removing costs along with site reconstruction costs will be required to:

1. Measure the liability on January 1, 2007 in conformity with generally accepted accounting principles;
2. Compute the amount that would have been included in the cost of the relevant asset, when the liability was initially created, by capitalizing the amount of the liability, as noted in item 1 above at the time when that liability was initially created (the Capitalized Amount);
3. Compute the Capitalized Amount's accumulated depreciation on January 1, 2007 on the basis of the asset's useful life at that time;
4. The difference between the amount to be allocated to the asset, in accordance with items 2 and 3 above and the amount of the liability, based on item 1 above, will be allocated to retained earnings.

The Company is currently examining this new standard; however, at this stage, it is unable to estimate the standard's effect, if any, on its financial position, results of operations. In January 2007 the Israeli Accounting Standard Board published a proposal for accounting standard no. 28 that amends standard no.27 to allow, at transition, the alternatives allowed under IFRS 1 regarding fixed assets.

**MONDI BUSINESS PAPER HADERA LTD.  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2    SIGNIFICANT ACCOUNTING POLICIES (cont.)**

**M.    Recent Accounting Standards (cont.)**

***Application of Standard No.29    Adoption of International Financial Reporting Standards***

In July 2006, the Israeli Accounting Standards Board published Accounting Standard No. 29 - Adoption of International Financial Reporting Standards - IFRS ( the Standard ). According to this Standard, the financial statements of an entity subject to the Israeli Securities Law and authoritative Regulations thereunder, other than foreign corporations as defined by this Law that prepares its financial statements in other than Israeli GAAP, will be prepared for the reporting periods commencing January 1, 2008, including interim periods, in accordance with the IFRS and related interpretations published by the International Accounting Standards Board.

An entity adopting IFRS as of January 1, 2008 and electing to report comparative figures in accordance with the IFRS for only 2007, will be required to prepare opening balance-sheet amounts as of January 1, 2007 based on the IFRS.

Reporting in accordance with the IFRS will be carried out based on the provisions of IFRS No. 1, First-time Adoption of IFRS Standards , which establishes guidance on implementing the transition from financial reporting based on domestic national accounting standards to reporting in accordance with the IFRS.

IFRS No. 1 supersedes the transitional provisions established in other IFRSs (including those established in former domestic national accounting standards), stating that all IFRSs should be adopted retroactively for the opening balance-sheet amounts. Nevertheless, IFRS No. 1 grants allowances on certain issues by not applying the retroactive application in respect thereof. In addition, IFRS No. 1 contains certain exceptions with regard to the retroactive application of certain aspects stipulated in other IFRSs.

Management intends to examine the effect of the transition to IFRS, yet at this stage, is unable to estimate the extent of such conversion on the Company 's financial position and results of operations.

Standard No. 29 allows for earlier application in a manner by which applicable entities may convert their financial statements published subsequent to July 31, 2006 to the IFRS. Management has not yet decided whether to early-adopt the IFRS.

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
(Reported amounts)  
(NIS in thousands)

**NOTE 3    TRADE RECEIVABLES**

	<b>Consolidated</b>	
	<b>As of December 31,</b>	
	<b>2 0 0 6</b>	<b>2 0 0 5</b>
<b>Domestic</b>		
Open accounts	137,585	117,150
Checks receivable	26,575	29,538
	164,160	146,688
<b>Foreign</b>		
Open accounts	4,680	4,311
Related parties	7,188	12,135
	11,868	16,446
	176,028	163,134
<u>Less</u> - allowance for doubtful accounts	(2,854)	(2,259)
	173,174	160,875

**NOTE 4    OTHER RECEIVABLES**

	<b>Consolidated</b>		<b>Company</b>	
	<b>As of December 31,</b>			
	<b>2 0 0 6</b>	<b>2 0 0 5</b>	<b>2 0 0 6</b>	<b>2 0 0 5</b>
Deferred taxes (Note 20D)	2,376	6,899	1,524	5,876
Prepaid expenses	952	527	739	2,161
Advances to suppliers	1,861	2,642	1,300	2,640
Value Added Tax	-	-	3,913	4,065
Income tax advances, net	138	207	10	-
Others	1,283	597	364	71
	6,610	10,872	7,850	14,813

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 5**    **INVENTORIES**

	Consolidated		Company	
	As of December 31,			
	2006	2005	2006	2005
Raw and auxiliary materials	33,630	38,134	33,630	38,134
Finished products and goods in process (*)	78,413	78,725	41,224	52,320
	112,043	116,859	74,854	90,454
(*) Includes products in transit	4,440	857	-	-
The inventories are presented net of impairment provision	540	715	518	418

**NOTE 6**    **INVESTMENTS IN SUBSIDIARIES**

	Company	
	As of December 31,	
	2006	2005
<b>A.    <u>Composition</u></b>		
Cost of shares	4,338	4,338
Accumulated losses since acquisition, net	(2,909)	(1,743)
	1,429	2,595
	1,429	2,595
	Consolidated	
	As of December 31,	
	2006	2005
<b>B.    <u>Goodwill</u></b>		
Cost	6,232	6,232
Less - accumulated amortization	3,055	3,055
	3,177	3,177
	3,177	3,177

C. **Consolidated Subsidiaries**

The consolidated financial statements as of December 31, 2006, include the financial statements of the following Subsidiaries:

	<b>Ownership and control As of December 31, 2006</b>
	%
Mondi Business Paper Hadera Marketing Ltd.	100.00
Grafinir Paper Marketing Ltd.	100.00
Yavnir (1999) Ltd.	100.00
Miterani Paper Marketing 2000 (1998) Ltd.	100.00



**MONDI BUSINESS PAPER HADERA LTD.**  
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**NOTE 7      FIXED ASSETS**

	<u>Leasehold improvements</u>	<u>Machinery and equipment</u>	<u>Motor vehicles</u>	<u>Office Furniture, Computers and equipment</u>	<u>Total</u>
<b><u>Consolidated</u></b>					
<b>Cost:</b>					
Balance - January 1, 2006	3,724	193,133	2,482	3,130	202,469
Changes during 2006:					
Additions	-	8,062	776	245	9,083
Dispositions	-	(158)	(151)	-	(309)
Balance - December 31, 2006	3,724	201,037	3,107	3,375	211,243
<b>Accumulated depreciation:</b>					
Balance - January 1, 2006	2,204	37,472	1,557	1,899	43,132
Changes during 2006:					
Additions	389	9,819	306	393	10,907
Dispositions	-	(6)	(151)	-	(157)
Balance - December 31, 2006	2,593	47,285	1,712	2,292	53,882
<b>Net book value:</b>					
December 31, 2006	1,131	153,752	1,395	1,083	157,361
December 31, 2005	1,520	155,661	925	1,231	159,337
<b><u>Company</u></b>					
<b>Cost:</b>					
Balance - January 1, 2006	2,651	191,840	1,223	2,166	197,880
Changes during 2006:					
Additions	-	8,062	776	245	9,083
Dispositions	-	(158)	-	-	(158)
Balance - December 31, 2006	2,651	199,744	1,999	2,411	206,805
<b>Accumulated depreciation:</b>					
Balance - January 1, 2006	1,570	36,558	373	1,295	39,796
Changes during 2006:					
Additions	265	9,716	211	321	10,513
Dispositions	-	(6)	-	-	(6)
Balance - December 31, 2006	1,835	46,268	584	1,616	50,303
<b>Net book value:</b>					
December 31, 2006	816	153,476	1,415	795	156,502

	<u>Leasehold improvements</u>	<u>Machinery and equipment</u>	<u>Motor vehicles</u>	<u>Office Furniture, Computers and equipment</u>	<u>Total</u>
December 31, 2005	1,081	155,282	850	871	158,084

**MONDI BUSINESS PAPER HADERA LTD.**  
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**NOTE 8** **TRADE PAYABLES**

	<u>Consolidated</u>		<u>Company</u>	
	<u>As of December 31,</u>			
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
In Israeli currency	29,006	27,539	24,351	21,690
In foreign currency or linked thereto	79,001	75,445	48,107	53,677
	<u>108,007</u>	<u>102,984</u>	<u>72,458</u>	<u>75,367</u>

**NOTE 9** **OTHER PAYABLES AND ACCRUED EXPENSES**

	<u>Consolidated</u>		<u>Company</u>	
	<u>As of December 31,</u>			
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Accrued payroll and related expenses	12,719	13,772	12,719	13,772
Value Added Tax	1,559	1,030	-	-
Advances from customers	1,165	448	-	-
NHBV - Accrual for license fee	910	3,241	-	-
Interest payable	2,803	1,049	2,803	1,049
Other	1,728	662	1,698	565
	<u>20,884</u>	<u>20,202</u>	<u>17,220</u>	<u>15,386</u>

**NOTE 10** **LONG-TERM BANK LOANS**

	<u>Interest rate</u>	<u>Consolidated and Company</u>	
		<u>As of December 31,</u>	
		<u>2006</u>	<u>2005</u>
<b>A. Composition</b>			
In U.S. dollar (**)	6.67	7,627	21,221
In NIS indexed to the CPI	6.55	41,485	16,828
		<u>49,112</u>	<u>38,049</u>
Less - current maturities		<u>15,243</u>	<u>16,242</u>
		<u>33,869</u>	<u>21,807</u>

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(\*) Average interest rate as of December 31, 2006.

(\*\*) As of December 31, 2006, NIS 6,360 thousand bear interest based on Libor plus + 0.5%-0.6%.

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
**(Reported amounts)**  
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**NOTE 10** **LONG-TERM BANK LOANS (cont.)**

	<u>Consolidated and Company</u>
	<u>As of December 31,</u>
	<u>2006</u>
<b>B. <u>Maturities</u></b>	
First year - 2007	15,243
Second year - 2008	12,052
Third year - 2009	12,790
Fourth year - 2010	7,824
Fifth year - 2011	1,202
	49,111
<b>C.</b>	According to the loan agreements with the banks, as amended in the second half of 2005, the Company has to achieve, inter alia, financial ratio at the end of each audited fiscal year of total shareholders equity (which includes capital notes to shareholders) to total assets to be no less than 22%. In case the Company fails to fulfill these covenants, the banks are entitled to demand early repayment of the loans, in whole or in part.
	As of December 31, 2006, the Company was in full compliance with the covenants stipulated in the bank agreements and this financial ratio amounted to 22.31%.
<b>D.</b>	As to a negative pledge agreement signed by the Company, see Note 13B.
<b>E.</b>	In 2004 and 2003, the Company and its Subsidiaries entered into an agreement for a bank credit facility, pursuant to which the Company and its Subsidiaries may, from time to time, borrow an aggregate principal amount of up to adjusted NIS 122,000 thousand. Under the terms of the agreement, the credit facility has no time limit. As of the balance sheet date, the Group utilized NIS 96,740 thousand of the credit facility.

**NOTE 11** **CAPITAL NOTES TO SHAREHOLDERS**

The capital notes to shareholders are linked to the dollar and bear no interest. According to the terms of the capital notes, the Company has the ultimate discretion upon the dates of repayment of the capital notes.

As of December 31, 2006 the total capital notes amount is NIS 12,675 thousand. Management intends to repay NIS 6,337 thousand of the capital note balance during 2007.

**NOTE 12** **ACCRUED SEVERANCE PAY, NET**

Israeli law and labor agreements determine the obligations of the Group to make severance payments to dismissed employees and to employees leaving employment under certain other circumstances. The liability for severance pay benefits, as determined by Israeli Law, is based upon length of service and the employee's most recent monthly salary. The liability of the Group for severance pay to its permanent employees is covered by current deposits to pension and severance funds. Accumulated amounts so funded are not under the control or administration of the Group, and accordingly, neither those amounts nor the corresponding

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accruals are reflected in the financial statements. The amounts presented in the balance sheet as of December 31, 2006 reflects the severance pay liability in respect of temporary employees.

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
**(Reported amounts)**  
**(NIS in thousands)**

**NOTE 13**    **COMMITMENTS AND CONTINGENT LIABILITIES**

**A.    Commitments:**

- (1)    The Group is obligated to pay license fees to a shareholder (see Note 21).
- (2)    The Company and its Subsidiaries lease certain of their facilities under operating leases for varying periods with renewal options primarily from AIPM. Future minimum lease rentals as of December 31, 2006 are as follows:

	<b>Consolidated</b>	<b>Company</b>
2007	4,510	3,380
2008	4,367	3,380
2009	3,380	3,380
	12,257	10,140

**B.    Liens**

To secure long-term bank loans and short-term bank credits (the balance of which as of December, 31 2006 is NIS 161,094 thousand), the Company entered into a negative pledge agreement under which the Company is committed not to pledge any of its assets, excluding fixed pledges relating to assets financed by others, prior to the consent of the banks.

**C.    Guarantees**

The Company from time to time and in the course of its ongoing operations provides guarantees, the amount of which as of December, 31 2006 was NIS 23,603 thousand.

**NOTE 14**    **SHARE CAPITAL**

- A.**    As of December 31, 2006 and 2005, share capital is composed of ordinary shares of NIS 1.00 par value each. Authorized 38,000 shares; issued and paid up 1,000 shares.
- B.**    Holders of ordinary shares are entitled to participate equally in the payment of cash dividends and bonus share (stock dividend) distributions and, in the event of the liquidation of the Company, in the distribution of assets after satisfaction of liabilities to creditors (See also Note 1A).

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 15 NET SALES**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Industrial operations	534,214	460,383	471,190	534,214	462,177	482,698
Commercial operations	177,331	202,955	214,904	-	-	-
	<b>711,545</b>	<b>663,338</b>	<b>686,094</b>	<b>534,214</b>	<b>462,177</b>	<b>482,698</b>

**NOTE 16 COST OF SALES**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Purchases (*)	165,168	187,618	188,013	-	-	-
Materials consumed	343,801	306,803	297,006	343,801	306,803	297,006
Salaries and related expenses	38,082	36,391	32,576	38,082	36,391	32,576
Subcontracting	6,464	5,898	5,066	6,464	5,898	5,066
Energy costs	63,013	54,883	45,991	63,013	54,883	45,991
Depreciation	10,510	9,607	7,896	10,116	9,607	7,896
Other manufacturing costs and expenses (including rent)	28,884	29,939	31,124	28,660	29,093	30,336
	<b>655,922</b>	<b>631,139</b>	<b>607,672</b>	<b>490,136</b>	<b>442,675</b>	<b>418,871</b>
Change in finished goods , goods in process, and products in transit (**)	3,923	(21,387)	(1,934)	10,944	(22,117)	(2,367)
	<b>659,845</b>	<b>609,752</b>	<b>605,738</b>	<b>501,080</b>	<b>420,558</b>	<b>416,504</b>

(\*) The purchases of the Group are related principally to commercial operations.

(\*\*) Change in raw and auxiliary materials are included in materials consumed.



**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
(Reported amounts)  
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**NOTE 17 SELLING EXPENSES**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Salaries and related expenses	19,190	17,205	17,169	10,793	(*) 13,554	(*) 13,520
Packaging and shipping to customers	13,469	16,719	16,235	12,296	16,096	15,464
Maintenance and rent	8,494	8,237	7,973	3,421	(*) 4,747	(*) 4,315
Transportation expenses	1,995	1,360	1,256	1,119	(*) 1,066	(*) 895
Advertising	70	166	-	39	(*) 131	-
Commissions and license fees to a shareholder	961	1,164	2,912	-	-	-
Depreciation	327	417	552	184	(*) 330	(*) 412
Other	-	-	38	-	-	-
	<u>44,506</u>	<u>45,268</u>	<u>46,135</u>	<u>27,852</u>	<u>35,924</u>	<u>34,606</u>

(\*) Reclassified.

**NOTE 18 GENERAL AND ADMINISTRATIVE EXPENSES**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Salaries and related expenses	3,829	3,863	3,811	3,829	3,863	3,811
Office maintenance	209	169	187	-	-	-
Professional and management fees	1,792	2,060	2,217	1,353	1,537	1,555
Depreciation	70	74	47	70	74	40
Amortization of goodwill	-	623	623	-	-	-
Bad and doubtful debts	1,627	(840)	(311)	-	-	-
Other	1,718	1,352	1,229	1,536	1,228	1,036
	<u>9,245</u>	<u>7,301</u>	<u>7,803</u>	<u>6,788</u>	<u>6,702</u>	<u>6,442</u>

**NOTE 19 FINANCING INCOME (EXPENSES), NET**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Interest on long-term bank loans	5,803	2,486	2,573	5,803	4,935	2,573
Erosion of monetary assets and liabilities, net	(3,036)	5,630	2,070	(3,702)	4,883	1,293

	Consolidated			Company		
Forward transaction	515	(1,497)	1,322	515	(1,497)	1,322

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 20 INCOME TAXES (TAXES BENEFITS)**

- A. The Company and its Subsidiaries are taxed according to the provisions of The Income Tax Ordinance and the Income Tax Law (Inflationary Adjustments), 1985. The Company is an industrial company in conformity with the Law for the Encouragement of Industry (Taxes), 1969. The major benefit the Company is entitled to under this law is accelerated depreciation rates.

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004

**B. Composition**

Current taxes	79	54	81	-	-	-
Taxes in respect of prior years	102	36	(86)	8	-	-
Deferred taxes (D. below)	(1,330)	(8,470)	823	(1,501)	(8,470)	359
	(1,149)	(8,380)	818	(1,493)	(8,470)	359

**C. Reconciliation of the statutory tax rate to the effective tax rate**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Income (loss) before income taxes	(8,868)	(11,786)	18,080	(8,045)	(12,540)	17,550
Statutory tax rate	31%	34%	35%	31%	34%	35%
Tax computed by statutory tax rate	(2,727)	(4,007)	6,328	(2,494)	(4,264)	6,143
<b>Tax increments (savings) due to:</b>						
Non-deductible expenses	16	212	211	4	-	-
Non-taxable income	(78)	(22)	(40)	-	-	(21)
Reduction in corporate tax rates - (E. below)	-	(3,888)	(4,397)	-	(3,962)	(4,479)
Differences arising from basis of measurement	1,538	(711)	(1,198)	989	(244)	(1,284)
Prior years income taxes	102	36	(86)	8	-	-
	(1,149)	(8,380)	818	(1,493)	(8,470)	359

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 20 INCOME TAXES (TAXES BENEFITS) (cont.)****D. Deferred Taxes**

	<u>Consolidated</u>			<u>Company</u>		
	<u>Year ended December 31,</u>			<u>Year ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance as of beginning year	(13,001)	(21,471)	(20,648)	(14,024)	(22,494)	(22,135)
Changes during the year	1,330	4,582	(5,220)	1,501	4,508	(4,838)
Adjustment due to change in income tax rates	-	3,888	4,397	-	3,962	4,479
Balance as of end of year	<u>(11,671)</u>	<u>(13,001)</u>	<u>(21,471)</u>	<u>(12,523)</u>	<u>(14,024)</u>	<u>(22,494)</u>

	<u>Consolidated</u>		<u>Company</u>	
	<u>As of December 31,</u>			
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>

Deferred taxes are presented in the balance sheets as follows:

Other receivables and prepayments (Note 4):

Allowance for doubtful accounts	852	700	-	-
Vacation and recreation pay	1,524	1,589	1,524	1,589
Carry forward tax losses	-	4,609	-	4,287
	<u>2,376</u>	<u>6,899</u>	<u>1,524</u>	<u>5,876</u>
Long-term liabilities:				
Depreciable fixed assets	(25,401)	(23,596)	(25,401)	(23,596)
Accrued severance pay, net	11	13	11	13
Less- Carry forward tax losses	11,343	3,683	11,343	3,683
	<u>(14,047)</u>	<u>(19,900)</u>	<u>(14,047)</u>	<u>(19,900)</u>
	<u>(11,671)</u>	<u>(13,001)</u>	<u>(12,523)</u>	<u>(14,024)</u>

For 2005-2006 - Deferred taxes were computed at rates between 31%-25%, primarily - 25%.

Deferred taxes are recognized in respect of all carry forward losses of the Group, see F.

**MONDI BUSINESS PAPER HADERA LTD.**  
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**NOTE 20 INCOME TAXES (TAXES BENEFITS) (cont.)****E. Reduction of Corporate Tax Rates**

In July 2005, the Israeli Knesset passed the Law for Amending the Income Tax Ordinance (No. 147), 2005, according to which commencing in 2006 the corporate income-tax rate would be gradually reduced, for which a 31% tax rate was established, through 2010, in respect of which a 25% tax rate was established. The effect of this amendment on the Group's deferred income tax provisions is reflected by an increase of NIS 3,888 thousand in income tax benefit for the year ended December 31, 2005.

F. Carryforward tax losses of the Group and the Company are NIS 51,044 thousand and NIS 50,271 thousand as of December 31, 2006, respectively.

G. The Company and its Subsidiaries have tax assessments that are final through the 2002 tax year.

**NOTE 21 RELATED PARTIES AND INTERESTED PARTIES****A. Balances with Related Parties and Subsidiaries**

	<u>Consolidated</u>		<u>Company</u>	
	<u>As of December 31,</u>			
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Trade receivables - AIPM	-	-	102,609	227,368
Trade receivables - related parties	7,188	12,135	-	-
Trade payables - AIPM	62,807	69,854	-	-
Trade payables - related parties	4,714	4,032	133,834	150,862
Other payables and accrued expenses - AIPM	2,402	2,406	2,208	2,406
Other payables and accrued expenses - related parties	910	3,241	-	-
Capital notes to shareholders	12,675	18,412	12,675	18,412

**MONDI BUSINESS PAPER HADERA LTD.**  
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**NOTE 21 RELATED PARTIES AND INTERESTED PARTIES (cont.)****B. Transactions with Related Parties and Subsidiaries**

	Consolidated			Company		
	Year ended December 31,			Year ended December 31,		
	2006	2005	2004	2006	2005	2004
Sales to related parties	96,520	103,196	165,596	-	-	-
Sales to Subsidiaries	-	-	-	534,214	462,177	482,698
Cost of sales	106,679	106,076	106,546	9,148	77,930	78,400
Selling expenses, net (Participation in selling expenses, net)	4,413	5,969	9,875	(8,564)	(450)	1,796
General and administrative expenses	1,234	1,750	1,837	935	1,447	1,480
Financing expenses (income), net	2,361	2,406	1,939	2,361	1,845	2,268

- C. (1) The Company leases its premises from AIPM and receives services (including electricity, water, maintenance and professional services) under agreements, which are renewed every year.
- (2) The Group is obligated to pay commissions and license fees to NAG.

**NOTE 22 DISCLOSURE AND PRESENTATION OF FINANCIAL INSTRUMENTS****A. Credit Risk**

The Group's revenue derives from a large number of customers mainly in Israel and in Europe. Management regularly monitors the balance of trade receivables and the financial statements include an allowance for doubtful accounts based on management's estimation. Taking the aforementioned into consideration, the exposure to credit risk from trade receivables is immaterial.

Cash and cash equivalents (including amounts in foreign currency) are deposited with major commercial banks in Israel.

**B. Fair Value of Financial Instruments**

The financial instruments of the Group consist primarily of non-derivative assets and liabilities. Non-derivative assets include cash and cash equivalents, receivables and other current assets. Non-derivative liabilities include short-term bank credit, trade payables, other current liabilities, long-term loans from banks and capital notes to shareholders. Due to the nature of these financial instruments, their fair value, generally, is identical or close to the value at which they are presented in the financial statements, unless stated otherwise.

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The fair value of the long-term loans approximates their carrying value, since they bear interest at rates close to the prevailing market rates.

The Group enters from time to time into off-balance sheet financial instruments for hedging against currency and interest-rate risks.

**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
(NIS in thousands)

**NOTE 23 COMPANY S FINANCIAL STATEMENTS IN NOMINAL VALUES FOR TAX PURPOSES****A. Balance Sheets**

	<b>Company</b>	
	<b>As of December 31,</b>	
	<b>2 0 0 6</b>	<b>2 0 0 5</b>
<b>Current Assets</b>		
American Israeli Paper Mills Group, net	243,559	231,715
Other receivables	16,334	14,869
Inventories	74,854	90,454
	334,747	337,038
<b>Long-Term Investments</b>		
Investments in Subsidiaries	146	1,312
	153,900	155,315
<b>Fixed Assets, net</b>		
	153,900	155,315
<b>Long -Term Assets</b>		
Deferred Taxes	-	2,555
	488,793	496,220
<b>Current Liabilities</b>		
Short term bank credit	96,740	85,871
Current maturities of long-term bank loans	15,243	16,242
Capital notes to shareholders	6,337	18,412
Trade payables	72,458	75,367
Subsidiaries	133,834	148,844
Other payables and accrued expenses	17,220	15,386
	341,832	360,122
<b>Long term liabilities</b>		
Long-term bank loans	33,869	21,807
Capital notes to shareholders	6,338	-
Accrued severance pay, net	46	51
	40,253	21,858
<b>Shareholders' Equity</b>	106,708	114,240
	488,793	496,220



**MONDI BUSINESS PAPER HADERA LTD.**  
**NOTES TO FINANCIAL STATEMENTS**  
(NIS in thousands)

**NOTE 23 COMPANY S FINANCIAL STATEMENTS IN NOMINAL VALUES FOR TAX PURPOSES (cont.)****B. Statement of Operations**

	Year ended December 31,		
	2006	2005	2004
Net sales	534,214	462,177	482,698
Cost of sales	500,916	420,394	417,831
<b>Gross profit</b>	<b>33,298</b>	<b>41,783</b>	<b>64,867</b>
Selling expenses	27,766	35,904	34,598
General and administrative expenses	6,851	6,698	6,444
<b>Operating profit (loss)</b>	<b>(1,319)</b>	<b>(819)</b>	<b>23,825</b>
Financing (expenses) income, net	(6,539)	(11,533)	(7,143)
Other income, net	-	-	48
<b>Income (loss) before income tax benefits</b>	<b>(7,858)</b>	<b>(12,352)</b>	<b>16,730</b>
Income tax benefits	1,492	8,470	-
<b>Income (loss) after income tax benefits</b>	<b>(6,366)</b>	<b>(3,882)</b>	<b>16,730</b>
Equity in net earnings (losses) of Subsidiaries	(1,166)	664	272
<b>Net income (loss) for the year</b>	<b>(7,532)</b>	<b>(3,218)</b>	<b>17,002</b>

**C. Statements of Changes in Shareholders' Equity**

	Share Capital	Premium	Retained earnings	Total
<b>Balance - January 1, 2004</b>	1	41,125	59,330	100,456
<b>Changes during 2004:</b>				
Net income for the year	-	-	17,002	17,002
<b>Balance - December 31, 2004</b>	1	41,125	76,332	117,458
<b>Changes during 2005:</b>				
Loss for the year	-	-	(3,218)	(3,218)
<b>Balance - December 31, 2005</b>	1	41,125	73,114	114,240
<b>Changes during 2006:</b>				
Loss for the year	-	-	(7,532)	(7,532)
<b>Balance - December 31, 2006</b>	1	41,125	65,582	106,708

**Item 19(a)(iii)**

**HOGLA-KIMBERLY LTD.**

**FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2006**

**HOGLA-KIMBERLY LTD.**

**FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2006**

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**HOGLA-KIMBERLY LTD.**  
**BALANCE SHEETS**  
**(REPORTED AMOUNTS)**  
(NIS in thousands)

	Note	Consolidated		Company	
		December 31,		December 31,	
		2006	2005	2006	2005
<b>Current Assets</b>					
Cash and cash equivalents	3	7,190	35,551	1,358	25,831
Trade receivables	4	263,126	257,899	108,281	120,427
Other receivables	5	53,746	59,805	23,783	14,196
Inventories	6	177,862	148,077	93,867	76,840
		501,924	501,332	227,289	237,294
<b>Long-Term Investments</b>					
Capital note of shareholder	7	32,770	32,770	32,770	32,770
Investments in Subsidiaries	8	-	-	166,276	286,133
		32,770	32,770	199,046	318,903
<b>Fixed Assets</b>					
Cost	9	547,386	542,377	443,923	419,215
Less - accumulated depreciation		253,245	235,144	208,071	179,400
		294,141	307,233	235,852	239,815
<b>Other Assets</b>					
Goodwill	8B	22,338	24,737	-	-
Deferred taxes	21	30,788	26,559	-	-
		53,126	51,296	-	-
		881,961	892,631	662,187	796,012
<b>Current Liabilities</b>					
Short-term bank credit		152,856	66,559	43,800	-
Current maturities of long-term bank loans	12	-	20,714	-	-
Trade payables	10	204,936	215,772	121,121	303,710
Other payables and accrued expenses	11	58,040	51,920	32,780	16,115
		415,832	354,965	197,701	319,825
<b>Long-Term Liabilities</b>					
Deferred taxes	21	35,364	38,566	33,721	36,003
<b>Commitments and Contingent Liabilities</b>					
	14				
<b>Minority Interest</b>					
		-	58,916	-	-
<b>Shareholders' Equity</b>					

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		<u>Consolidated</u>		<u>Company</u>	
Share capital	15	29,638	29,038	29,638	29,038
Capital reserves		230,153	180,414	230,153	180,414
Translation adjustments relating to foreign held autonomous Subsidiary		(14,393)	618	(14,393)	618
Accumulated other comprehensive income		(76)	-	(76)	-
Retained earnings		185,443	230,114	185,443	230,114
		<u>430,765</u>	<u>440,184</u>	<u>430,765</u>	<u>440,184</u>
		<u>881,961</u>	<u>892,631</u>	<u>662,187</u>	<u>796,012</u>

/s/ T. Davis

T. Davis

Chairman of the Board of Directors

/s/ O. Argov

O. Argov

Chief Financial Officer

/s/ A. Schor

A. Schor

Chief Executive Officer

Approval date of the financial statements: March 1, 2007.

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

**HOGLA-KIMBERLY LTD.**  
**STATEMENTS OF OPERATIONS**  
**(REPORTED AMOUNTS)**  
(NIS in thousands)

	Note	Consolidated			Company		
		Year ended December 31,			Year ended December 31,		
		2006	2005	2004	2006	2005	2004
Net sales	16	1,254,908	1,145,981	995,569	617,544	540,002	479,320
Cost of sales	17	883,908	820,715	719,982	496,986	452,694	393,903
<b>Gross profit</b>		371,000	325,266	275,587	120,558	87,308	85,417
Selling and marketing expenses	18	269,223	202,683	193,701	15,531	13,708	15,286
General and administrative expenses	19	57,906	56,283	41,029	6,110	5,040	4,985
<b>Operating profit</b>		43,871	66,300	40,857	98,917	68,560	65,146
Financing income (expenses), net	20	(25,627)	752	(1,490)	2,811	34	(4,536)
Other income, net		774	176	903	632	153	205
<b>Income before income taxes</b>		19,018	67,228	40,270	102,360	68,747	60,815
Income taxes	21	(35,903)	(19,527)	(10,244)	(33,733)	(18,895)	(17,627)
<b>Income after income taxes</b>		(16,885)	47,701	30,026	68,627	49,852	43,188
Equity in losses of Subsidiaries		-	-	-	(79,298)	(6,576)	(16,260)
Minority interest in losses (earnings) of Subsidiary		6,214	(4,425)	(3,098)	-	-	-
<b>Net income (loss) for the year</b>		(10,671)	43,276	26,928	(10,671)	43,276	26,928

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

**HOGLA-KIMBERLY LTD.**  
**STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**  
**(REPORTED AMOUNTS)**  
(NIS in thousands)

	<u>Share capital</u>	<u>Capital reserves</u>	<u>Translation adjustments relating to foreign held autonomous Subsidiary</u>	<u>Accumulate other comprehensive income</u>	<u>Retained earnings</u>	<u>Total</u>
<b>Balance - January 1, 2004</b>	28,788	156,799	-	-	227,394	412,981
<b>Changes during 2004:</b>						
Distribution of bonus shares	250	23,615	-	-	(23,865)	-
Translation adjustments relating to foreign held autonomous Subsidiary	-	-	(3,377)	-	-	(3,377)
Net income for the year	-	-	-	-	26,928	26,928
<b>Balance - December 31, 2004</b>	29,038	180,414	(3,377)	-	230,457	436,532
<b>Changes during 2005:</b>						
Translation adjustments relating to foreign held autonomous Subsidiary	-	-	3,995	-	-	3,995
Dividend paid	-	-	-	-	(43,619)	(43,619)
Net income for the year	-	-	-	-	43,276	43,276
<b>Balance - December 31, 2005</b>	29,038	180,414	618	-	230,114	440,184
<b>Changes during 2006:</b>						
Shares issued	600	49,739	-	-	-	50,339
Translation adjustments relating to foreign held autonomous Subsidiary	-	-	(15,011)	-	-	(15,011)
Movement in capital reserve of hedging transactions, net	-	-	-	(76)	-	(76)
Dividend paid	-	-	-	-	-	-