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AMERICAN ISRAELI PAPER MILLS LTD

Form 6-K/A

March 17, 2006

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 6-K/A  
Report of Foreign Private Issuer  
Pursuant to Rule 13a-16 or 15d-16  
of the Securities Exchange Act of 1934  
For the Month of March 2006  
-----

AMERICAN ISRAELI PAPER MILLS LTD.  
(Translation of Registrant's Name into English)  
P.O. Box 142, Hadera, Israel  
(Address of Principal Corporate Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F  Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

NOTE: Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

NOTE: Regulation S-T Rule 101(b)(7) only permits the submission in paper of a Form 6-K submitted to furnish a report or other document that the registrant foreign private issuer must furnish and make public under the laws of the jurisdiction in which the registrant is incorporated, domiciled or legally organized (the registrant's "home country"), or under the rules of the home country exchange on which the registrant's securities are traded, as long as the report or other document is not a press release, is not required to be and has not been distributed to the registrant's security holders, and, if discussing a material event, has already been the subject of a Form 6-K submission or other Commission filing on EDGAR.

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes  No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-\_\_\_\_\_

EXPLANATORY NOTE  
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This Report of Foreign Private Issuer on form 6-K amends the report on form 6-K filed by the Registrant on March 10, 2006 (the "Original 6-K") to replace the Auditor's Report of the Registrant, dated March 7, 2006, with a revised Auditor's Report, dated March 16, 2006.

The revised Auditor's Report added that the Auditor's have completed their review of the Registrant's financial statements in accordance with the standards of the Public Company Accounting Oversight Board.

No other amendments or changes, except the above mentioned, have been made to the Original 6-K or to the Registrant's financial statements included therein.

Attached hereto as Exhibit 1 and incorporated herein by reference are the Registrant's audited consolidated financial statements for the year ended December 31, 2005, including the revised Auditor's Report.

SIGNATURE

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMERICAN ISRAELI PAPER MILLS LTD.

(Registrant)

By: /s/ Lea Katz

-----  
Name: Lea Katz

Title: Corporate Secretary

Dated: March 17, 2006

EXHIBIT INDEX

| EXHIBIT NO. | DESCRIPTION   |
|-------------|---|
| 1.          | Registrant's audited consolidated financial statements. |

EXHIBIT 1

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AMERICAN ISRAELI PAPER MILLS LIMITED

2005 CONSOLIDATED FINANCIAL STATEMENTS

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## AMERICAN ISRAELI PAPER MILLS LIMITED 2005 CONSOLIDATED FINANCIAL STATEMENTS

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### AUDITORS' REPORT

To the shareholders of  
AMERICAN ISRAELI PAPER MILLS LIMITED

We have audited the consolidated balance sheets of American Israeli Paper Mills Limited (hereafter - the Company) and its subsidiaries as of December 31, 2005 and 2004 and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's board of directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain associated companies, the Company's interest in which as reflected in the balance sheets as of December 31, 2005 and 2004 is NIS 352.7 million and NIS 353.1 million, respectively, and the Company's share in excess of profits over losses of which is a net amount of NIS 19.2 million, NIS 25 million and NIS 28.2 million for the years ended December 31, 2005, 2004 and 2003, respectively. The financial statements of those companies were audited by other auditors whose reports have been furnished

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to us, and our opinion, insofar as it relates to amounts included for those companies, is based solely on the reports of the other auditors.

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

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004 and the consolidated results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted ("GAAP") in Israel. Furthermore, in our opinion, the financial statements referred to above have been prepared in accordance with the Israeli Securities (Preparation of Annual Financial Statements) Regulations, 1993 (see also note 1).

As explained in note 1b, the financial statements, as of dates and for reporting periods subsequent to December 31, 2003, are presented in new Israeli shekels, in conformity with accounting standards issued by the Israel Accounting Standards Board. The financial statements as of dates and for reporting periods ended prior to, or on, the above date are presented in values that have been adjusted for the changes in the exchange rate of the U.S. dollar through that date, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Tel-Aviv, Israel  
March 16, 2006

AMERICAN ISRAELI PAPER MILLS LIMITED  
CONSOLIDATED BALANCE SHEETS

|                           | NOTE | DECEMBER<br>-----<br>2005<br>----- |
|---------------------------|------|------------------------------------|
| NIS IN THOUSANDS (SEE     |      |                                    |
| -----                     |      |                                    |
| ASSETS                    |      |                                    |
| CURRENT ASSETS:           | 8    |                                    |
| Cash and cash equivalents | 10   | 8,318                              |

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|                                     |        |           |
|-------------------------------------|--------|-----------|
| Short-term investments              | 10a;1f | 11,416    |
| Accounts receivable:                | 10b    |           |
| Trade                               |        | 150,409   |
| Other                               |        | 106,124   |
| Inventories                         | 10c    | 63,999    |
|                                     |        | -----     |
| Total current assets                |        | 340,266   |
|                                     |        | -----     |
| INVESTMENTS AND LONG-TERM           |        |           |
| RECEIVABLES:                        |        |           |
| Investments in associated companies | 2;8    | 428,957   |
| Deferred income taxes               | 7f     | 5,655     |
|                                     |        | -----     |
|                                     |        | 434,612   |
|                                     |        | -----     |
| FIXED ASSETS:                       | 3      |           |
| Cost                                |        | 1,057,911 |
| Less - accumulated depreciation     |        | 677,977   |
|                                     |        | -----     |
|                                     |        | 379,934   |
|                                     |        | -----     |
| DEFERRED CHARGES,                   |        |           |
| net of accumulated amortization     | 1i     | 946       |
|                                     |        | -----     |
| Total assets                        |        | 1,155,758 |
|                                     |        | =====     |

\*Reclassified

|                 |                           |
|-----------------|---------------------------|
| -----           | ) CHAIRMAN OF THE         |
| YAKI YERUSHALMI | ) BOARD OF DIRECTORS      |
| -----           | )                         |
| AVI BRENER      | ) CHIEF EXECUTIVE OFFICER |
| -----           | )                         |
| ISRAEL ELDAR    | ) CONTROLLER              |

Date of approval of the financial statements: March 16, 2006

|       |                       |
|-------|-----------------------|
|       | DECEMBER              |
| NOTE  | 2005                  |
| ----- | -----                 |
|       | NIS IN THOUSANDS (SEE |
| ----- | -----                 |

LIABILITIES AND SHAREHOLDERS' EQUITY

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|  |     |           |
|--|-----|-----------|
| CURRENT LIABILITIES:                                   | 8   |           |
| Credit from banks                                      | 10d | 93,171    |
| Current maturities of long-term notes                  | 4a  | 6,827     |
| Accounts payable and accruals:                         | 10e |           |
| Trade  |     | 90,512    |
| Dividend payable                                       |     | 50,093    |
| Other  |     | 85,407    |
|  |     | -----     |
| Total current liabilities                              |     | 326,010   |
|  |     | -----     |
| LONG-TERM LIABILITIES:                                 |     |           |
| Deferred income taxes                                  | 7f  | 45,783    |
| Loans and other liability                              |     |           |
| (net of current maturities):                           | 4;8 |           |
| Notes  |     | 227,811   |
| Other liability  |     | 32,770    |
|  |     | -----     |
| Total long-term liability                              |     | 306,364   |
|  |     | -----     |
| COMMITMENTS AND CONTINGENT LIABILITIES                 | 9   |           |
| Total liabilities                                      |     | 632,374   |
|  |     | -----     |
| SHAREHOLDERS' EQUITY:                                  | 6   |           |
| Share capital (ordinary shares of NIS 0.01 par value:  |     |           |
| authorized - 20,000,000 shares; issued and paid:       |     | 125,257   |
| December 31, 2005 and 2004 - 4,002,205 and             |     |           |
| 3,996,674 shares, respectively)                        |     |           |
| Capital surplus  |     | 90,060    |
| Capital surplus resulting from tax benefit on exercise |     |           |
| of employee options                                    |     | 401       |
| Differences from translation of foreign currency       |     |           |
| financial statements of associated companies           |     | (813)     |
| Retained earnings                                      |     | 308,479   |
|  |     | -----     |
|  |     | 523,384   |
|  |     | -----     |
| Total liabilities and shareholders' equity             |     | 1,155,758 |
|  |     | =====     |

\*Reclassified

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS.

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|   |        |         |
|---|--------|---------|
| SALES - net   | 10f;14 | 482,461 |
| COST OF SALES   | 10g    | 383,179 |
| GROSS PROFIT  |        | 99,282  |
| SELLING, MARKETING, ADMINISTRATIVE<br>AND GENERAL EXPENSES:   | 10h    |         |
| Selling and marketing   |        | 30,482  |
| Administrative and general                                    |        | 21,018  |
|   |        | 51,500  |
| INCOME FROM ORDINARY OPERATIONS                               |        | 47,782  |
| FINANCIAL EXPENSES - net                                      | 10i    | 12,490  |
| OTHER INCOME  | 10j    |         |
| INCOME BEFORE TAXES ON INCOME                                 |        | 35,292  |
| TAXES ON INCOME   | 7      | 5,991   |
| INCOME FROM OPERATIONS OF THE<br>COMPANY AND ITS SUBSIDIARIES |        | 29,301  |
| SHARE IN PROFITS OF ASSOCIATED<br>COMPANIES - net             | 2      | 16,414  |
| NET INCOME FOR THE YEAR                                       |        | 45,715  |
| NET INCOME PER NIS 1 OF PAR VALUE<br>OF SHARES                | 1p;11  | 1,127   |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS.

AMERICAN ISRAELI PAPER MILLS LIMITED  
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

|  |                   |
|--|-------------------|
|  | DIFFERENC<br>FROM |
|  | FROM              |
|  | TRANSLATI         |
|  | OF                |
|  | FOREIGN           |
|  | CURRENCY          |
|  | FINANCIA          |
|  | STATEMETN         |
| CAPITAL<br>SURPLUS<br>RESULTING<br>FROM TAX<br>BENEFIT ON<br>EXERCISE OF |                   |

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|   | SHARE<br>CAPITAL            | CAPITAL<br>SURPLUSES | EMPLOYEE<br>OPTIONS | ASSOCIATED<br>COMPANIES |
|---|-----------------------------|----------------------|---------------------|-------------------------|
|   | NIS IN THOUSANDS (SEE NOTE) |                      |                     |                         |
| BALANCE AT JANUARY 1, 2003  | 125,256                     | 90,060               |                     | (3,48)                  |
| CHANGES IN 2003:  |                             |                      |                     |                         |
| Net income  |                             |                      |                     |                         |
| Dividend paid   |                             |                      |                     |                         |
| Exercise of employee options<br>into shares   | 1                           |                      |                     |                         |
| Differences from currency<br>translation resulting from<br>translation of financial<br>statements of associated companies |                             |                      |                     | 2,36                    |
| BALANCE AT DECEMBER 31, 2003  | 125,257                     | 90,060               |                     | (1,12)                  |
| CHANGES IN 2004:  |                             |                      |                     |                         |
| Net income  |                             |                      |                     |                         |
| Dividend paid   |                             |                      |                     |                         |
| Exercise of employee options<br>into shares   | *                           |                      |                     |                         |
| Differences from currency translation<br>resulting from translation of<br>financial statements of associated<br>companies |                             |                      |                     | (1,68)                  |
| BALANCE AT DECEMBER 31, 2004  | 125,257                     | 90,060               |                     | (2,80)                  |
| CHANGES IN 2005:  |                             |                      |                     |                         |
| Net income  |                             |                      |                     |                         |
| Dividend **   |                             |                      |                     |                         |
| Exercise of employee options<br>into shares   | *                           |                      | 401                 |                         |
| Differences from currency translation<br>resulting from translation of<br>financial statements of<br>associated companies |                             |                      |                     | 1,99                    |
| BALANCE AT DECEMBER 31, 2005  | 125,257                     | 90,060               | 401                 | (81)                    |

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

\*\* 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.



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|   | 2005<br>----       | 2004<br>---- |
|---|--------------------|--------------|
|   | NIS IN THOUSANDS ( |              |
|   | -----              |              |
| CASH FLOWS FROM OPERATING ACTIVITIES:   |                    |              |
| Net income for the year   | 45,715             | 62,732       |
| Adjustments to reconcile net income to<br>net cash provided by operating activities (A) | 42,845             | (15,637)     |
|   | -----              | -----        |
| Net cash provided by operating activities   | 88,560             | 47,095       |
|   | -----              | -----        |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |                    |              |
| Purchase of fixed assets  | (71,080)           | (30,952)     |
| Short-term investments  | 51,003             | (42,000)     |
| Associated companies:   |                    |              |
| Granting of loans   | (2,744)            | (779)        |
| Collection of loans   |                    | 13,688       |
| Proceeds from sale of subsidiary consolidated in the past (B)                           | 2,004              |              |
| Proceeds from sale of fixed assets  | 6,532              | 1,001        |
|   | -----              | -----        |
| Net cash used in investing activities   | (14,285)           | (59,042)     |
|   | -----              | -----        |
| CASH FLOWS FROM FINANCING ACTIVITIES:   |                    |              |
| Notes issuance, net of issuance expenses of NIS 800,000                                 |                    |              |
| Consideration in respect of the exercise of options by employees                        |                    |              |
| Receipt of long-term loans from others  | 1,746              |              |
| Repayment of long-term loans from banks and others                                      | (277)              | (383)        |
| Redemption of notes   | (6,680)            | (6,666)      |
| Dividend paid   | (49,946)           | (99,964)     |
| Short-term credit from banks - net  | (18,613)           | (31,933)     |
|   | -----              | -----        |
| Net cash provided by (used in) financing activities                                     | (73,770)           | (138,946)    |
|   | -----              | -----        |
| INCREASE (DECREASE) IN CASH AND<br>CASH EQUIVALENTS                                     | 505                | (150,893)    |
| BALANCE OF CASH AND CASH EQUIVALENTS AT<br>BEGINNING OF YEAR                            | 7,813              | 158,706      |
|   | -----              | -----        |
| BALANCE OF CASH AND CASH EQUIVALENTS AT<br>END OF YEAR                                  | 8,318              | 7,813        |
|   | =====              | =====        |

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CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | 2005             | 2004    |
|--|------------------|---------|
|  | -----            | -----   |
|  | NIS IN THOUSANDS |         |
|  | -----            | -----   |
| (A) ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:                  |                  |         |
| Income and expenses not involving cash flows:  |                  |         |
| Share in profits of associated companies - net   | (16,414)         | (2,000) |
| Dividend received from associated company  | 21,761           | 2,000   |
| Depreciation and amortization  | 31,604           | 2,000   |
| Deferred income taxes - net  | (7,671)          | (1,000) |
| Capital losses (gains) on:   |                  |         |
| Sale of fixed assets   | (3,570)          | (1,000) |
| Sale of subsidiary consolidated in the past (B)  | (874)            | (1,000) |
| Losses (gains) on short-term deposits and investments  | 45               | (1,000) |
| Linkage and exchange differences (erosion) on principal of long-term loans from banks and others - net | (111)            | (1,000) |
| Linkage differences on principal of notes  | 6,171            | (1,000) |
| Linkage differences on principal of long-term loans granted to associated companies                    | (975)            | (1,000) |
| Appreciation of a long-term capital note granted to an associated company                              | (1,000)          | (1,000) |
|  | -----            | -----   |
|  | 29,966           | (1,000) |
|  | -----            | -----   |
| Changes in operating asset and liability items:  |                  |         |
| Increase in trade receivables  | (7,162)          | (1,000) |
| Increase in other receivables (excluding deferred income taxes)  | (1,587)          | (1,000) |
| Decrease (increase) in inventories   | (1,612)          | (1,000) |
| Increase (decrease) in trade payables  | 3,018            | (1,000) |
| Increase (decrease) in other payables and accruals   | 20,222           | (1,000) |
|  | -----            | -----   |
|  | 12,879           | (1,000) |
|  | -----            | -----   |
|  | 42,845           | (1,000) |
|  | =====            | =====   |
| SUPPLEMENTARY DISCLOSURE OF CASH FLOW INFORMATION:   |                  |         |
| Income taxes paid  | 1,559            | (1,000) |
|  | =====            | =====   |
| Interest paid  | 15,828           | 2,000   |
|  | =====            | =====   |

|     |  |         |
|-----|--|---------|
| (B) | PROCEEDS FROM SALE OF SUBSIDIARY CONSOLIDATED IN THE PAST - see also note 10h:             |         |
|     | Assets and liabilities of the subsidiary consolidated in the past at the date of its sale: |         |
|     | Working capital (excluding cash and cash equivalents)                                      | 509     |
|     | Fixed assets   | 1,979   |
|     | Long-term liabilities  | (1,358) |
|     | Capital gain from the sale   | 874     |
|     |  | -----   |
|     |  | 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 was not paid yet. The Company's share in this dividend amounts to NIS 2,650,000.
- 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.

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 required by the transition to nominal financial reporting in 2004 (see b below), and the implementation for the first time of Clarification No. 7 in 2005 (see j(7) below), were applied on a consistent basis, are as follows:

A. GENERAL:

- 1) Activities of the Group

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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.

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### 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).

1) Transition to nominal financial reporting in 2004

With effect from January 1, 2004, the Company has adopted the provisions of Israel Accounting Standard No. 12 - "Discontinuance of Adjusting Financial Statements for Inflation" - of the Israel Accounting Standards Board (hereafter -the IASB) and, pursuant thereto, the Company has discontinued, from the aforesaid date, the adjustment of its financial statements for the changes in the exchange rate of the U.S. dollar (hereafter - the dollar) against the shekel.

The amounts adjusted for the changes in the exchange rate of the dollar against the shekel (see (2) below), presented in the financial statements as of December 31, 2003 (hereafter - "the transition date"), were used as the opening balances for the nominal financial reporting as of January 1, 2004. Additions made after the transition date have been included in the financial statements at their nominal values.

Accordingly, the amounts reported for 2003, as well as reported amounts for subsequent periods, that relate to non-monetary assets (including the depreciation and amortization thereon), investments in associated companies 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, on the basis of the exchange rate 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.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

Through December 31, 2003, the Company prepared its financial statements on the basis of historical cost adjusted for the changes in the exchange rate of the dollar, (see also note 8b) as permitted under Opinion 36 of the Institute of Certified Public Accountants in Israel (hereafter - the Israeli Institute).

Through 2003, the components of the income statements were, for the most part, adjusted as follows: the components relating to transactions

carried out during the reported period - sales, purchases, labor costs, etc. - were adjusted on the basis of the date on which the transaction was carried out, while those relating to non-monetary balance sheet items (mainly - changes in inventories and depreciation) were adjusted on the same basis as the related balance sheet item. The financing component represents financial income and expenses in real terms and the erosion of balances of monetary items during the year.

The investment in some of the associated companies (whose operations constitute an integral part of the Company's operations) and the Company's share in their operating results are recorded on the basis of the adjusted financial statements (in accordance with the provisions of Standard No. 12, as described above) of these companies. As to associated companies whose financial statements were adjusted until December 31, 2003 on the basis of the changes in the Israeli CPI, see (3) below.

- 2) The amounts of non-monetary assets do not necessarily represent realization value or current economic value, but only the reported amounts of such assets, as described in (1) above. In these financial statements, the term "cost" signifies cost in reported amounts.
- 3) Associated companies whose financial statements are adjusted on the basis of the changes in the Israeli CPI

For purposes of inclusion on the equity basis, until December 31, 2003, the amounts included in the financial statements of the above associated companies operating independently, were treated as follows:

Balance sheet items at the end of the year and the results of operations for the year reflect the amounts presented in the financial statements of such companies. Balance sheet items at the beginning of the year and changes in shareholders' equity items during the year were adjusted on the basis of the changes in the exchange rate of the dollar at the beginning of the year or at the date of each change, respectively, through the end of the year. Any differences resulting from the treatment described above were carried to the adjusted shareholders' equity under a separate item ("differences from translation of foreign currency financial statements of associated companies").

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### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

As from January 1, 2004, no additional differences have been included in respect of said companies, in view of their transition to reporting under Standard 12, as also applied by the Company.

#### 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.
- 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%.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

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:

YEARS

|  |                         |
|--|-------------------------|
| Buildings  | 10-50 (mainly 33)       |
| Machinery and equipment                              | 7-20 (mainly 10 and 20) |
| Vehicles   | 5-7 (mainly 7)          |
| Office furniture and equipment (including computers) | 3-17 (mainly 4)         |

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.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

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 q(1) 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 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, except for taxes derived from the initial recognition of business combinations and except for the tax in respect of transactions that are recognized directly in shareholders' equity (in such instances, the applicable tax is taken directly to shareholders' equity).
- 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.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

- 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,

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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

Revenue from sale of products on the local market and for export, net of discounts granted, is recognized upon the transfer of ownership to the buyer (in accordance with the sale conditions).

### 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. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

### NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

#### O. CASH EQUIVALENTS

The Group 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.

#### P. NET INCOME PER NIS 1 OF PAR VALUE OF SHARES

Net income per NIS 1 of par value of shares is computed in accordance with Opinion 55 of the Israeli Institute; as to the data used in the per share computation - see

note 11.

Q. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS IN ISRAEL

- 1) In August 2005, the IASB issued Israel Accounting Standard No. 22 - "Financial Instruments: Disclosure and Presentation", which is based on International Accounting Standard No. 32. This standard prescribes the rules for the presentation of financial instruments and the proper disclosure required therefor. The standard prescribes the rules pursuant to which financial instruments are to be classified and are to be presented as a liability (while broadening the definition of a financial liability) or as an equity instrument (presented within shareholders' equity). The standard also prescribes rules for bifurcating and classifying compound financial instruments (that include both an equity component and a liability component), the circumstances under which the offsetting of financial assets and financial liabilities is permitted, and the treatment of the costs of issuing financial instruments. The standard also prescribes that interest, dividends, losses and gains relating to financial instruments shall be recorded as income or expense in the income statements when the instrument is classified as a financial liability, or as an equity movement when the instrument is classified as an equity instrument, respectively.

This accounting standard is to be applied to financial statements for periods commencing on or after January 1, 2006, and is to be applied prospectively. Upon initial implementation of the standard, all the financial instruments existing at the transition date will be classified and presented in accordance with the classification and presentation rules prescribed by the standard; compound financial instruments will be bifurcated into their components, prior to said classification, in accordance with the transitional provisions prescribed by the standard. Comparative data will not be restated.

When the standard takes effect, the Israeli Institute's Opinion 48 - "Accounting Treatment of Option Warrants", and Opinion 53 - "Accounting Treatment of Convertible Liabilities" will be revoked.

The balance of deferred issuance costs relating to the notes, which at December 31, 2005 amounted to NIS 946,000 will be reclassified at the time of the standard taking effect and will be presented as a deduction from the amount of the liability to which such expenses relate.

These costs will be amortized, in future reporting periods, according to the interest method. The change in the amortization method will not have a material effect on operating results in future reporting periods.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

- 2) In September 2005, the IASB issued Accounting Standard Israel No. 24 - "Share-based Payment". This standard prescribes the recognition and measurement principles, as well as the disclosure requirements, relating to share-based payment transactions. Prior to the issuance of said standard, no mandatory directives were in place in Israel for the measurement and recognition of share-based payment transactions, with the exception of certain disclosure requirements. Accordingly, in the past, equity instrument grants to Company employees did not have recognition or measurement implications on the Company's financial statements.

The new standard is applicable to transactions whereunder a company acquires goods or receives services in consideration for equity instruments of the company (hereafter - equity grant), or cash (or other assets) consideration, where the amount of the consideration is based on the price or value of equity instruments of the company (hereafter - liability grant). The standard requires the recognition of such transactions at fair value. The standard is applicable to share-based payment transactions with employees and non-employees.

With respect to equity grants to employees, the standard stipulates that the value of the labor services received from them in return is to be measured on the day of the grant, based on the fair value of the equity instruments that were granted to the employees. The value of the transactions, measured in the above manner, is to be expensed over the period that the employee's right to exercise or receive the underlying equity instruments vests; commensurate with the recognition of the expense, a corresponding increase is to be recorded as a capital surplus under the company's shareholders' equity.

According to the provisions of the standard, the initial measurement of the fair value of liability grants is to be made on the date of the grant and recognized as a liability in the company's balance sheet; thereafter, the liability is to be remeasured at each balance sheet date until said liability is settled. The changes in the amount of the liability are carried to the income statement on a current basis. The standard also sets out guidelines for the allocation of income taxes in respect of share-based payments.

Accounting Standard No. 24 is to be applied to financial statements covering periods commencing on, or after, January 1, 2006.

The transitional provisions of the standard make a distinction between equity grants and liability grants:

- a) For equity grants, the standard prescribes that its provisions are to be applied to all grants that are made subsequent to March 15, 2005, which had not yet vested at the effective date of the standard. As a result, upon the standard taking effect, the financial statements for 2005 will need to be restated in order to reflect such grants.
- b) The provisions of the standard shall be retroactively applicable to liabilities relating to liability grants existing at the effective date. As a result, upon the standard taking effect, the financial statements for all prior periods will need to be restated in order to reflect these grants.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

The transitional provisions of the standard further stipulate that any modifications to the terms of existing grants executed subsequent to March 15, 2005 shall be subject to the provisions of the standard, even if the grants themselves are not. As a result, upon the standard taking effect, the financial statements for 2005 will need to be restated in order to reflect such modifications.

The Company intends to implement the provisions of the standard starting from 2006. The Company has a liability in respect of a liability grant, regarding which the effect of the retroactive implementation of the provisions of the standard, for each of the relevant years and cumulatively, is immaterial.

In addition, new grants of options or shares to employees or service providers of the Company, would result, in the following reporting periods, in the recording of payroll expenses or expenses relating to the cost of the services, at their fair value.

- 3) In February 2006, the IASB issued Israel Accounting Standard No. 21 - "Earnings per Share", which is based on International Accounting Standard No. 33. Accounting Standard No. 21 provides rules for the computation of earnings per share data and their presentation in the financial statements, and is to supersede, starting from its effective date, the existing rules relating to the

computation and presentation of such data, which are based on Opinion 55 of the Israeli Institute; the standard is to be applied in financial statements for periods commencing on or after January 1, 2006.

According to the standard, the computation of basic earnings per share is generally based on the earnings available for distribution to holders of ordinary shares, which is divided by the weighted average number of ordinary shares outstanding during the period. This computation no longer takes into account the effect relating to potential shares that may derive from the expected conversion of convertible financial instruments, or the performance of contracts that confer rights to shares upon their holders.

In computing the diluted earnings or loss per share, the weighted average number of shares to be issued is to be added to the average number of ordinary shares used in the computation of the basic earnings per share data, assuming that all dilutive potential shares will be converted into shares. The potential shares are taken into account, as above, only when their effect is dilutive (reducing the earnings or increasing the loss per share from continuing activities); for the purpose of the computation of the weighted average, dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares. The standard also revises the treatment of the effect on the earnings resulting from the expected conversion of potential shares, and makes certain adjustments to the Company's share in the operating results of associated companies and consolidated subsidiaries for the purpose of their inclusion in earnings used for the computation.

Upon the initial adoption of the standard, and in accordance with the transitional provisions stipulated therein, the comparative earnings per share data are to be restated in the financial statements, in order to reflect, with retroactive effect, the computation of the earnings per share under the new directives.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

In the opinion of the Company, the implementation of this standard is not expected to have a material effect on the earnings per share data included in

these financial statements.

- 4) In February 2006, the IASB issued Israel Accounting Standard No. 25 - "Revenue", which is based on International Accounting Standard No. 18. This standard prescribes recognition, measurement, presentation and disclosure criteria for revenues originating from the sale of goods purchased or manufactured by the company, the provision of services, as well as revenues deriving from the use of the company's assets by others (interest income, royalties or dividends).

The principal issue in accounting for revenue is determining the timing of revenue recognition. Revenue from the sale of goods shall be 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.

Revenue from the provision of services shall be recognized by reference to the stage of completion of the transaction at the balance sheet date, subject to the satisfaction of conditions (c) through (e) above, and only when the stage of completion of the transaction at the balance sheet date can be measured reliably.

A clarification of said standard was issued by the IASB in February 2006: Clarification No. 8 - "Reporting of Revenue on a Gross or Net Basis". According to the clarification, a company acting as an agent or an intermediary, without bearing the risks and rewards resulting from the transaction, will present its revenue on a net basis (as profit or commission). However, a company that acts as a principal supplier and bears the risks and rewards resulting from the transaction will present its revenue on a gross basis, distinguishing the turnover from the related expenses.

Standard 25 shall be applicable to financial statements for periods commencing on or after January 1, 2006. The standard is to be applied prospectively; nevertheless, in accordance with the transitional provisions of the standard, the classification and presentation of revenue on a gross or net basis, as above, shall be applied with retroactive effect, including the restatement of revenues and expenses appearing in the comparative figures in the financial statements for periods commencing on the effective date of the standard.

Until the publication of said standard and the



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related clarification, there were no accounting pronouncements, and the accounting treatment of this issue was mostly based on generally accepted accounting practices and foreign accounting pronouncements. The company is currently examining the effect of the implementation of this standard on its financial statements in future periods.

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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:

Shares:

|   |     |
|---|-----|
| Cost  | 54  |
| Excess of cost of investment - net  | 2   |
| Less - accumulated amortization   | (2) |
| Gain on issuance of shares of an associated company to a third party            | 40  |
| Adjustments resulting from translation of foreign currency financial statements | (   |
| Share in profits (after deduction of losses) accumulated since acquisition      | 263 |

Long-term loans and capital notes \*

—  
 2  
 —  
 —  
 54  
 2  
 (2)  
 40  
 (  
 263  
 ---  
 356  
 72  
 ---  
 428  
 ===

\* Classified by linkage terms, the total amounts of the loans and capital notes are as follows:

|                                  | WEIGHTED AVERAGE<br>INTEREST RATE<br>AT DECEMBER 31,<br>2005 | ---              |
|----------------------------------|--|------------------|
|                                  | -----<br>%<br>-----  | ---              |
| In dollars                       |  | 9,               |
| Linked to the Israeli CPI***     |  | 20,              |
| Unlinked loans and capital notes | 2.2%   | 63,<br>72,<br>== |

\*\* Reclassified.

\*\*\* In 2005, the terms of the loans linked to the Israeli CPI were changed and these loans became unlinked loans.

As of December 31, 2005, the repayment dates of the balance of the loans and capital notes have not yet been determined.

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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 2005 ARE AS FOLLOWS:

Balance at beginning of year

Changes during the year:

Share in profits of associated companies - net

Dividend from associated companies

Adjustments resulting from translation of foreign currency  
financial statements

Increase in balance of long-term loans and capital notes - net

Balance at end of year

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

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Company and also by Neusiedler AG (hereafter - Neusiedler), 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 Neusiedler 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)

The investment in Carmel's shares, as of December 31, 2005 and 2004, amounts to NIS 32,897,000 and NIS 32,300,000, respectively, which represents a holding of 26.25%. Carmel's shares are traded in the United States on the "AMEX" Stock Exchange.

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

NOTE 2 - INVESTMENTS IN ASSOCIATED COMPANIES (continued):

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.

The financial statements of Carmel are drawn up in accordance with the provisions of Accounting Standard No. 12 of the IASB. Until December 31, 2003, the financial statements were drawn up on the basis of cost, adjusted for the changes in the general purchasing power of Israeli currency measured on the basis of the Israeli CPI. For purposes of inclusion in the consolidated financial statements up to said date, Carmel's financial statements were adjusted on the basis of the changes in the exchange rate of the dollar.

G. INVESTMENT IN T.M.M INTEGRATED RECYCLING INDUSTRIES LTD.  
(HEREAFTER - T.M.M.)

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As of December 31, 2005, the Company's share in T.M.M. (directly and through another associated company) is 43.08%

The excess of equity in net assets of T.M.M. shares, over the cost of the investment therein, which amounts to NIS 1,581,000, is amortized over a period of ten years.

As of December 31, 2005 and 2004, the direct investment in the shares of T.M.M is NIS 13,703,000 and NIS 15,726,000, respectively. The market value of these shares as of December 31, 2005 and 2004 is NIS 10,436,000 and NIS 11,338,000, respectively.

The Company's management examined the value of its investment in T.M.M. for impairment, which is not temporary in nature. The Company used the services of an outside appraiser in determining the value in use to the Company. Based on this, the Company's management believes that the investment does not need to be written down.

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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 2005, ARE AS FOLLOWS:

|   | COST                               |                                 |                                   |                        |
|---|------------------------------------|---------------------------------|-----------------------------------|------------------------|
|   | BALANCE AT<br>BEGINNING<br>OF YEAR | ADDITIONS<br>DURING<br>THE YEAR | RETIREMENTS<br>DURING<br>THE YEAR | BALANCE<br>END<br>YEAR |
|   | -----                              | -----                           | -----                             | -----                  |
|   | NIS IN THOUSANDS                   |                                 |                                   |                        |
|   | -----                              | -----                           | -----                             | -----                  |
| Land and buildings thereon                              | 189,227                            | 40,369                          | 774                               | 228,8                  |
| Machinery and equipment                                 | 673,753                            | 16,681                          | 1,036                             | 689,3                  |
| Vehicles  | 29,954                             | 5,362                           | 4,220                             | 31,0                   |
| Office furniture and equipment<br>(including computers) | 68,362                             | 2,073                           | 269                               | 70,1                   |
| Payments on account of<br>machinery and equipment       | 13,166                             | 4,166                           | 2,165                             | 15,1                   |
| Spare parts - not current                               | 20,833*                            | 2,429                           |                                   | 23,2                   |
|   | -----                              | -----                           | -----                             | -----                  |
|   | 995,295                            | 71,080                          | 8,464                             | 1,057,9                |
|   | =====                              | =====                           | =====                             | =====                  |

|   | ACCUMULATED DEPRECIATION                    |  |  |                                    |
|---|---|--|--|------------------------------------|
|   | BALANCE AT<br>BEGINNING<br>OF YEAR<br>----- | ADDITIONS<br>DURING<br>THE YEAR<br>----- | RETIREMENTS<br>DURING<br>THE YEAR<br>----- | BALANCE<br>END OF<br>YEAR<br>----- |
|   | NIS IN THOUSANDS                            |  |  |                                    |
| Land and buildings thereon                              | 107,585                                     | 3,496                                    | 277  | 110,8                              |
| Machinery and equipment                                 | 467,827                                     | 22,031                                   | 902  | 488,9                              |
| Vehicles  | 19,884                                      | 3,307                                    | 2,276                                      | 20,9                               |
| Office furniture and equipment<br>(including computers) | 54,760                                      | 2,610                                    | 68   | 57,3                               |
| Payments on account of<br>machinery and equipment       |   |  |  |                                    |
| Spare parts - not current                               |   |  |  |                                    |
|   | -----<br>650,056<br>=====                   | -----<br>31,444<br>=====                 | -----<br>3,523<br>=====                    | -----<br>677,9<br>=====            |

\*Reclassified.

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 44.5 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, 2005 and 2004, 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 31,444,000 NIS 28,472,000 and NIS 28,165,000, for the years ended December 31, 2005, 2004 and 2003, respectively.
- F. As to pledges on assets - see note 9a.

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

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, 2005 |          |            |
|---------------------------|-------------------|----------|------------|
|                           | -----             |          |            |
|                           | 2005              |          |            |
|                           | -----             |          |            |
|                           | NIS IN THOUSANDS  |          |            |
|                           | -----             |          |            |
|                           | SERIES II         | SERIES I | SERIES III |
|                           | -----             |          |            |
| Balance                   | 207,229           | 27,409   | 20,582     |
| Less - current maturities |                   | 6,827    |            |
|                           | -----             | -----    | -----      |
|                           | 207,229           | 20,582   | 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 102,501,000, in December 2005 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.

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.

As to the change from January 2006 in the presentation of deferred issuance costs - see note 1q (1) above.

B. OTHER LIABILITY:

The capital note to an associated company is unlinked and interest free. No repayment date has been fixed, but the associated company does not intend to demand the

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repayment of the capital note before January 1, 2007.

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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 8,710,000 NIS 8,368,000, and NIS 8,515,000 in 2005, 2004, and 2003, respectively.

NOTE 6 - SHAREHOLDERS' EQUITY:

- A. SHARE CAPITAL

Composed of ordinary registered shares of NIS 0.01 par value, as follows:

|                  | AUTHORIZED | DECEMBER 31, 2005<br>ISSUED AND PAID UP |
|------------------|------------|---|
| Number of shares | 20,000,000 | 4,002,205                               |
| Amount in NIS    | 200,000    | 40,022                                  |

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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, 2005 are NIS 195.4 and \$ 42.51 (NIS 195.67), respectively.

### B. EMPLOYEE STOCK OPTION PLANS:

#### 1) The 1998 plan for senior officers in the Group

On January 11, 1998, the board of directors approved a stock option plan for senior officers in the Group ("the 1998 plan for senior officers").

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

#### NOTE 6 - SHAREHOLDERS' EQUITY (continued):

In 1998-2000, 155,498 options were granted under the 1998 plan for senior officers.

The number of shares resulting from the exercise of the options and the actual exercise price were determined as follows: Upon receipt of an exercise request from an option holder, a computation was 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 was then multiplied by the number of exercisable options (hereafter - the benefit). The number of shares that the Company actually issued to the option holder was the number of shares the market value of which was equal to the amount of the benefit computed as above. In consideration for the shares, the option holder paid their par value only.

In 2000-2003, 154,000 options were exercised under the 1998 plan for senior officers. 92,832 shares of NIS 0.01 were issued following the exercise. The unexercised balance of 1,498 options granted expired in 2003.

Immediately upon issuance, the ordinary shares issued upon exercise of the options have all the same rights as other ordinary shares of the Company.

#### 2) 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, 2005 is NIS 45.5 for the second batch, NIS 103.43 for the third batch and NIS 157.02 for the fourth batch. In May 2005, the remaining options from the first 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.

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

NOTE 6 - SHAREHOLDERS' EQUITY (continued):

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.

In 2005, 2004 and 2003, 13,877, 55,525 and 1,550 options, respectively, were exercised under the 2001 plan for senior officers, and 4,307, 24,295 and 227 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). As of December 31, 2005, the unexercised balance of the options granted is 115,098.

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.

3) 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.

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

NOTE 6 - SHAREHOLDERS' EQUITY (continued):

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%. As stipulated by the 2001 employee plan, the exercise price has been adjusted, as a result of dividend distributions, and it is NIS 91.16 as of December 31, 2005.

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 171.20. Immediately prior to the granting of the options, the price was NIS 138.80.

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 64.11 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 options to be exercised (hereafter - the benefit). The number of shares the that 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.

In 2005, 2004 and 2003, 2,405, 8,615 and 57,962 options, respectively, were exercised under the 2001 employee plan, and 1,224, 4,084 and 20,665 shares of NIS 0.01, respectively, were issued following the exercise of options, as above. As of December 31, 2005, the unexercised balance of the options granted is 12,473.

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.

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

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 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.

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

NOTE 7 - TAXES ON INCOME (continued):

- 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 22,470,000 and NIS 20,239,000 as of December 31, 2005 and 2004, 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 2005 and 2004, are as follows:

| In respect of balance sheet items Provisions for employee r |                                |             |                  |                                      |          |
|---|--------------------------------|-------------|------------------|--------------------------------------|----------|
|   | Depreciable<br>fixed<br>assets | Inventories | Severance<br>pay | Vacation<br>and<br>recreation<br>pay | Do<br>Ac |
|   | -----                          | -----       | ---              | ---                                  | ---      |
|   | NIS in thousands               |             |                  |                                      |          |
|   | -----                          | -----       | ---              | ---                                  | ---      |
| Balance at January 1, 2004                                  | 61,802                         | 3,386       | 688              | (4,297)                              | (5       |
| Changes in 2004:  |                                |             |                  |                                      |          |
| Amounts carried to income                                   | (9,240)                        | 652         | (87)             | 210                                  | ---      |
| Balance at December 31, 2004                                | 52,562                         | 4,038       | 601              | (4,087)                              | (5       |
| Changes in 2005:  |                                |             |                  |                                      |          |
| Amounts carried to income                                   | (6,779)                        | (1,487)     | (75)             | 8                                    | ---      |
| Balance at December 31, 2005                                | 45,783                         | 2,551       | 526              | (4,079)                              | (5       |
|   | =====                          | =====       | ===              | =====                                | ==       |

The deferred taxes are computed at the rate of 25%-31%.

Deferred taxes are presented in the balance sheets as follows:

|                                   | DECEMBER   |
|-----------------------------------|------------|
|                                   | 2005       |
|                                   | -----      |
|                                   | NIS IN THO |
|                                   | -----      |
| Among current assets              | (7,106)    |
| Among long-term asset balances    | (5,655)    |
| Among long-term liabilities       | 45,783     |
|                                   | -----      |
| Balance - liability (asset) - net | 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:

|   |         |
|---|---------|
|   | 2005    |
|   | ----    |
|   | -----   |
| For the reported year:                              |         |
| Current   | 13,662  |
| Deferred, see f. above:                             |         |
| In respect of changes to tax rates,<br>see d. above | (4,166) |
| In respect of the reporting period                  | (3,505) |
|   | -----   |
|   | 5,991   |
|   | =====   |

Current taxes in 2005 were computed at an average tax rate of 34%, 2004 - 35% and 2003 - 34.5%, 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:

|  | 2005   |                     | 2004   |             |
|--|--------|---------------------|--------|-------------|
|  | %      | NIS IN<br>THOUSANDS | %      | NIS<br>THOU |
|  | ---    | -----               | ---    | -----       |
| Income before taxes on income, as reported<br>in the statements of income  | 100.0  | 35,292              | 100.0  | 40          |
|  | =====  | =====               | =====  | ==          |
| Theoretical tax on the above amount  | 34.0   | 11,999              | 35.0   | 14          |
| Tax benefits arising from reduced tax rate<br>for approved enterprises   | -----  | -----               | -----  | ---         |
|  | 34.0   | 11,999              | 35.0   | 14          |
| Decrease in taxes resulting from computation<br>of deferred taxes at a rate which is<br>different from the theoretical rate                              | (0.9)  | (324)               | (4.3)  | (1          |
| Decrease in taxes resulting from adjustment to<br>deferred tax balances due to changes<br>in tax rates, see d. above                                     | (11.8) | (4,166)             | (14.3) | (5          |
| Tax deduction in respect of options<br>exercised by employees according to<br>Section 102 of the Israeli Income<br>Tax Ordinance (2005 - see note 1j(7)) | (4.3)  | (1,518)             | (10.3) | (4          |
| Other - net  | (4.3)  | (1,518)             | 1.6    | ---         |
|  | -----  | -----               | -----  | ---         |
| Taxes on income for the reported year  | 17.0   | 5,991               | 7.7    | 3           |
|  | =====  | =====               | =====  | ==          |



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H. TAX ASSESSMENTS

The Company and most of its subsidiaries have received final tax assessments through the year ended December 31, 2000.

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

NOTE 8 - LINKAGE TERMS OF MONETARY BALANCES:

A. AS FOLLOWS:

|  | DECEMBER 31, 2005   |                              |          |                                   |
|--|---|------------------------------|----------|-----------------------------------|
|  | IN, OR LINKED<br>TO, FOREIGN<br>CURRENCY<br>(MAINLY DOLLAR) | LINKED TO THE<br>ISRAELI CPI | UNLINKED | IN, OR<br>TO, F<br>CUR<br>(MAINLY |
|  | NIS IN THOUSANDS  |                              |          |                                   |
| <b>Assets:</b>   |   |                              |          |                                   |
| <b>Current assets:</b>   |   |                              |          |                                   |
| Cash and cash equivalents  | 5,740   |                              | 2,578    | 4,53                              |
| Short-term investments   |   |                              | 11,416   |                                   |
| Receivables  | 55,307  | 167                          | 189,912  | 43,60                             |
| Investments in associated companies -<br>long-term loans and capital notes | 9,206   |                              | 63,125   | 8,61                              |
|  | -----   | -----                        | -----    | -----                             |
|  | 70,253  | 167                          | 267,031  | 56,74                             |
|  | =====   | =====                        | =====    | =====                             |
| <b>Liabilities:</b>  |   |                              |          |                                   |
| <b>Current liabilities:</b>  |   |                              |          |                                   |
| Short-term credit from banks   |   |                              | 93,171   | 2,23                              |
| Accounts payables and accruals   | 11,062  | 868                          | 214,082  | 10,10                             |
| <b>Long-term liabilities (including<br/>current maturities):</b>           |   |                              |          |                                   |
| Notes  |   | 234,638                      |          |                                   |
| Other liability  |   |                              | 32,770   |                                   |
|  | -----   | -----                        | -----    | -----                             |
|  | 11,062  | 235,506                      | 340,023  | 12,33                             |
|  | =====   | =====                        | =====    | =====                             |

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:

|                     | CHANGE RATE OF<br>ONE DOLLAR<br>-----<br>NIS<br>--- | CPI*<br>-----<br>POINTS<br>----- |
|---------------------|---|----------------------------------|
| AT END OF YEAR:     |   |                                  |
| 2005                | 4.603   | 185.0                            |
| 2004                | 4.308   | 180.7                            |
| 2003                | 4.379   | 178.6                            |
| CHANGE IN THE YEAR: |   |                                  |
| 2005                | 6.8%  | 2.4%                             |
| 2004                | (1.6%)  | 1.2%                             |
| 2003                | (7.6%)  | (1.9%)                           |

\* 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. In 1996, an associated company received a grant amounting to NIS 2,067,000 from the Fund for Preparation for Exposure of the Ministry of Industry and Trade. With respect to this grant, the Company has provided a bank guarantee of NIS 2,091,000 in favor of the State of Israel.

- C. The Company has provided guarantees of NIS 2,301,000 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.
- D. Subsidiaries provided guarantees to various entities, in connection with tenders, in the aggregate amount of approximately NIS 2,232,000.

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

NOTE 9 - COMMITMENTS, CONTINGENT LIABILITIES AND LIABILITIES SECURED BY  
PLEDGES (continued):

- E. 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 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. Up to December 31 2005, one quarter of the remuneration was exercised. An additional quarter was exercised in January 2006, after the balance sheet date. A liability was included in the financial statements in respect of the above plan, under current liabilities.
- F. 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.
- G. 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 2006, 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

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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 (euro) 1.74 million, for the purchase of the systems needed for the conversion and assistance with their installation at the plant in Hadera.

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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,

2005  
-----

A. SHORT-TERM INVESTMENTS:  
Short term deposit - linked to the CPI  
Marketable securities

B. RECEIVABLES:  
1) Trade:  
Open accounts  
Checks collectible

The item is:  
Net of allowance for doubtful accounts

Includes associated companies

2) Other:  
Employees and employee institutions  
Associated companies - current debt  
Prepaid expenses

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Advances to suppliers  
 Deferred income taxes, see note 7f  
 Income tax authority  
 Interest receivable  
 Sundry

C. INVENTORIES:

For industrial activities:  
 Finished goods  
 Raw materials and supplies

For commercial activities - purchased products

Maintenance and spare parts \*\*

D. CREDIT FROM BANKS:

|              |      |
|--------------|------|
| Unlinked     | 5.3% |
| Swiss francs |      |

\* Reclassified.

\*\* Including inventories for the use of associated companies.

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

NOTE 10 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

E. ACCOUNTS PAYABLE AND ACCRUALS - OTHER:

|                | DECEMBER   |
|----------------|------------|
|                | -----      |
|                | 2005       |
|                | -----      |
|                | NIS IN THO |
|                | -----      |
| 1) Trade:      |            |
| Open accounts  | 84,727     |
| Checks payable | 5,785      |

|   |        |
|---|--------|
|   | -----  |
|   | 90,512 |
|   | =====  |
| 2) Other:                               |        |
| Payroll and related expenses            | 44,587 |
| Institutions in respect of employees    | 11,855 |
| Income tax authority                    | 15,655 |
| Customs and value added tax authorities | 142    |
| Accrued interest                        | 1,209  |
| Accrued expenses                        | 9,201  |
| Sundry                                  | 2,758  |
|   | -----  |
|   | 85,407 |
|   | =====  |

STATEMENTS OF INCOME:

|  | 2005    | 2004    |
|--|---------|---------|
|  | ----    | ----    |
|  |         | NIS IN  |
|  |         | -----   |
| F. SALES - net (1):                                |         |         |
| Industrial operations (2)                          | 364,539 | 363,000 |
| Commercial operations                              | 117,922 | 119,000 |
|  | -----   | -----   |
|  | 482,461 | 482,000 |
|  | =====   | =====   |
| (1) Including sales to associated companies        | 115,262 | 121,000 |
|  | -----   | -----   |
| (2) Including sales to export                      | 43,356  | 42,000  |
|  | =====   | =====   |
| G. COST OF SALES: Industrial operations:           |         |         |
| Materials consumed                                 | 80,740  | 83,000  |
| Payroll and related expenses                       | 96,370  | *92,000 |
| Depreciation                                       | 27,396  | 24,000  |
| Other manufacturing costs                          | 94,517  | *81,000 |
| Decrease (increase) in inventory of finished goods | (4,894) | 3,000   |
|  | -----   | -----   |
|  | 294,129 | 285,000 |
| Commercial operations - cost of products sold      | 89,050  | 90,000  |
|  | -----   | -----   |
|  | 383,179 | 375,000 |
|  | =====   | =====   |
| Including purchases from associated companies      | 37,747  | 26,000  |
| * Reclassified.                                    | =====   | =====   |

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NOTE 10 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

|   | 2005     |
|---|----------|
|   | -----    |
|   | NIS      |
|   | -----    |
| H. SELLING, MARKETING, ADMINISTRATIVE AND GENERAL EXPENSES:   |          |
| Selling and marketing:  |          |
| Payroll and related expenses  | 13,641   |
| Packaging, transport and shipping   | 7,866    |
| Commissions   | 2,699    |
| Depreciation  | 1,145    |
| Other   | 5,131    |
|   | -----    |
|   | 30,482   |
|   | =====    |
| Administrative and general:   |          |
| Payroll and related expenses  | 39,727   |
| Office supplies, rent and maintenance   | 1,241    |
| Professional fees   | 991      |
| Depreciation  | 2,903    |
| Doubtful accounts and bad debts   | 840      |
| Capital loss (gain) from sale of fixed assets   | (3,570)  |
| Other**   | 3,327    |
|   | -----    |
|   | 45,459   |
| Less - rent and participation from associated companies   | 24,441   |
|   | -----    |
|   | 21,018   |
|   | =====    |
| * Reclassified.   |          |
| ** 2005 - includes gain from sale of subsidiary consolidated in the past, in the amount of NIS 874,000. |          |
| I. FINANCIAL INCOME (EXPENSES) - NET*:  |          |
| EXPENSES:   |          |
| In respect of long-term loans - net   |          |
| In respect of notes - including amortization of deferred charges and net of related hedges              | 16,516   |
| In respect of short-term balances - net   | 3,559    |
|   | -----    |
|   | 20,075   |
|   | -----    |
| INCOME:   |          |
| In respect of increase in value of operating monetary balances  | 3,294    |
| In respect of short-term balances - net   | 4,291    |
|   | -----    |
|   | 7,585    |
|   | -----    |
|   | (12,490) |
|   | =====    |
| * Including financial income (expenses) in respect of loans to associated companies                     | 975      |

## AMERICAN ISRAELI PAPER MILLS LIMITED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## NOTE 10 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

## J. OTHER INCOME

In 2003, the Company sold apartments that it previously held for the use of its employees.

## NOTE 11 - NET INCOME PER NIS 1 OF PAR VALUE OF SHARES:

- A. The weighted average par value of shares used in computation of per share data is as follows:

| Year ended December 31: | NIS    |
|-------------------------|--------|
|                         | ---    |
| 2005                    | 40,553 |
|                         | =====  |
| 2004                    | 40,640 |
|                         | =====  |
| 2003                    | 40,197 |
|                         | =====  |

- B. In the reported years, shares that will be allocated upon exercise of unexercised stock options granted to employees were taken into account in computing per share data, having regard to the quoted price of the Company's share at the end of each year.

## 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 November-December 2004, the Company entered into forward transactions for a period of one year, in order to hedge an amount of NIS 200 million against increases in the Israeli CPI.



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 aforementioned transaction.

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

NOTE 12 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued):

B. CREDIT RISKS

The Company and its subsidiaries' cash and cash equivalents and the short-term deposit as of December 31, 2005 and 2004 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. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the financial instruments included in the working capital of the Company 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.

The Company does not disclose the fair value of long-term loans and capital notes included under investments in associated companies as of December 31, 2005, aggregating NIS 72,331,000 (see note 2b) and of a capital note to an associated company in the amount of NIS 32,770,000 (see note 4b), since their value cannot be reliably determined so long as they have no repayment dates.

NOTE 13 - INTERESTED PARTIES - TRANSACTIONS AND BALANCES:

A. TRANSACTIONS:

1) Income (expenses):

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|                    | 2005<br>----      | 2004<br>----     | 2003<br>----     |
|--------------------|-------------------|------------------|------------------|
|                    | NIS IN THOUSANDS  |                  |                  |
|                    | -----             |                  |                  |
| Sales              | 46,396<br>=====   | 45,278<br>=====  | 38,715<br>=====  |
| Costs and expenses | (13,997)<br>===== | (9,247)<br>===== | (7,009)<br>===== |
| Financial expenses | (1,731)<br>=====  | (1,688)<br>===== | <br>=====        |

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.

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

NOTE 13 - INTERESTED PARTIES - TRANSACTIONS AND BALANCES (continued)

2) Benefits to interested parties:

|  | 2005<br>----    | 2004<br>----    |
|--|-----------------|-----------------|
| Payroll to interested parties employed<br>by the Company - NIS in thousands            | *5,181<br>===== | *3,300<br>===== |
| Number of people to whom<br>the benefits relate  | 2<br>=====      | 2<br>=====      |
| Remuneration of directors who are not<br>employed by the Company -<br>NIS in thousands | 485<br>=====    | 528<br>=====    |
| Number of people to whom<br>the benefits relate  | 12<br>=====     | 13<br>=====     |

\*In 2005 including the CEO and the Chairman of the Board of Directors. In 2004 and 2003 a CEO was in a position only part of the year. In 2005 includes a special bonus to the Chairman of the Board of Directors, at a sum of NIS 800,000, subject to the general meeting's approval.

3) In 2003, an interested party employed by the Company (the chairman of the board of directors) exercised 15,999 options granted to him under the 1998 plan

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for senior employees. 8,529 shares of NIS 0.01 par value have been issued at par value against the exercise of said options.

- 4) At December 31, 2005, an interested party employed by the Company (the CEO) held 3,950 options under the 2001 plan for senior employees in the group (see note 6b(2)). In January 2006, after the balance sheet date, the interested party exercised 1,975 of said options.
- 5) As to the plan for the remuneration of the Company's chairman of the board of directors - see note 9e.

B. BALANCES WITH INTERESTED PARTIES:

|  | DEC    |
|--|--------|
|  | 2005   |
|  | NIS I  |
|  | -----  |
| Accounts receivable - commercial operations* | 12,225 |
|  | =====  |
| Accounts payables and accruals               | 4,401  |
|  | =====  |
| Notes  | 30,697 |
|  | =====  |

\* There were no significant changes in the balance during the year.

NOTE 14 - SEGMENT INFORMATION:

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:

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|  | PAPER AND RECYCLING |         |         | MARKETING OF OFFICE SUPPLIES |         |         |
|--|---------------------|---------|---------|------------------------------|---------|---------|
|  | 2005                | 2004    | 2003    | 2005                         | 2004    |         |
| NIS IN THOUSANDS   |                     |         |         |                              |         |         |
| Sales - net (1)  | 368,884             | 367,391 | 332,124 | 113,577                      | 115,463 | 132,000 |
| Income (loss) from ordinary operations                     | 48,662              | 58,496  | 46,282  | (880)                        | (4,566) |         |
| Financial expenses, net                                    |                     |         |         |                              |         |         |
| Other income   |                     |         |         |                              |         |         |
| Income before taxes on income                              |                     |         |         |                              |         |         |
| Taxes on income  |                     |         |         |                              |         |         |
| Income from operations of the Company and its subsidiaries |                     |         |         |                              |         |         |
| Share in profits of associated companies - net             |                     |         |         |                              |         |         |
| Net income   |                     |         |         |                              |         |         |
| Segment assets (at end of year)                            | 536,965             | 494,194 | 497,811 | 57,377                       | 56,707  | 59,000  |
| Unallocated corporate assets (at end of year) (2)          |                     |         |         |                              |         |         |
| Consolidated total assets (at end of year)                 |                     |         |         |                              |         |         |
| Segment liabilities (at end of year)                       | 57,754              | 58,782* | 58,906  | 32,758                       | 28,774* | 25,000  |
| Unallocated corporate liabilities (at end of year)         |                     |         |         |                              |         |         |
| Consolidated total liabilities (at end of year)            |                     |         |         |                              |         |         |
| Depreciation and amortization                              | 29,795              | 26,671  | 25,523  | 1,809                        | 1,962   | 2,000   |

\* Reclassified.

- (1) Represents sales to external customers.  
(2) Including investments in associated companies.

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## DETAILS OF SUBSIDIARIES AND ASSOCIATED COMPANIES

AT DECEMBER 31, 2005

|  | PERCENTAGE OF<br>INDIRECT HOLDING<br>CONFERRING E<br>VOTING R<br>-----<br>% |
|--|---|
| <b>MAIN SUBSIDIARIES:</b>  |   |
| Amnir Recycling Industries Limited   | 100.  |
| Graffiti Office Supplies and Paper Marketing Ltd.  | 100.  |
| Attar Marketing Office Supplies Ltd.   | 100.  |
| American Israeli Paper Mills Paper Industry (1995) Ltd.  | 100.  |
| <b>MAIN ASSOCIATED COMPANIES:</b>  |   |
| Hogla-Kimberly Ltd.  | 49.   |
| Subsidiaries of Hogla-Kimberly Ltd.:   |   |
| Hogla-Kimberly Marketing Limited   | 49.   |
| Molett Marketing Limited   | 49.   |
| Shikma For Personal Comfort Ltd.   | 49.   |
| Ovisan Sihhi Bez Sanai Ve Ticavet A.S.   | 49.   |
| Mondy Business Paper Hadera Ltd.   | 49.   |
| Subsidiary of Mondy Business Paper Hadera Ltd.:  |   |
| Mondy Business Paper Hadera Marketing Ltd.   | 49.   |
| Carmel Container Systems Limited   | 26.   |
| C.D. Packaging Systems Limited**   | 63.   |
| Barthelemi Holdings Ltd.   | 35.   |
| T.M.M. Integrated Recycling Industries Ltd.***   | 43.   |
| * Not including dormant companies.   |   |
| ** C.D. Packaging Systems Limited is partly held through Carmel Container Systems Limited (an associated company); the holding in voting shares of C.D. Packaging Systems Limited is 63.05%. |   |
| *** T.M.M Integrated Recycling Industries Ltd. is partly held directly and partly through Barthelemi Holdings Ltd.   |   |