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AMERICAN ISRAELI PAPER MILLS LTD
Form 6-K
March 10, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K
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-_____

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Attached hereto as Exhibit 1 and incorporated herein by reference is the Registrant's press release dated March 8, 2006 with respect to the Registrant's results of operations for the year ended December 31, 2005.

Attached hereto as Exhibit 2 and incorporated herein by reference is the Registrant's Management Discussion with respect to the Registrant's results of operations for the year ended December 31, 2005.

Attached hereto as Exhibit 3 and incorporated herein by reference are the Registrant's audited consolidated financial statements for the year ended December 31, 2005.

Attached hereto as Exhibit 4 and incorporated herein by reference are the audited consolidated financial statements of Mondi Business Paper Hadera Ltd. and subsidiaries with respect to the year ended December 31, 2005.

Attached hereto as Exhibit 5 and incorporated herein by reference are the audited consolidated financial statements of Hogla-Kimberly Ltd. and subsidiaries with respect to the year ended December 31, 2005.

SIGNATURE

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 9, 2006

EXHIBIT INDEX

| EXHIBIT NO. ----- | DESCRIPTION ----- |
|----------------------|---|
| 1. | Press release dated March 8, 2006. |
| 2. | Registrant's management discussion. |
| 3. | Registrant's audited consolidated financial statements. |
| 4. | Audited consolidated financial statements of Mondi Business Paper Hadera Ltd. and subsidiaries. |
| 5. | Audited consolidated financial statements of Hogla-Kimberly Ltd. and subsidiaries. |

NEWS

CLIENT: AMERICAN ISRAELI PAPER MILLS LTD.

AGENCY CONTACT: PHILIP Y. SARDOFF

FOR RELEASE: IMMEDIATE

AMERICAN ISRAELI PAPER MILLS LTD.
REPORTS FINANCIAL RESULTS FOR FISCAL YEAR ENDED DECEMBER 31, 2005

Hadera, Israel, March 8, 2006 - American Israeli Paper Mills Ltd. (ASE:AIP) (the "Company" or "AIPM") today reported financial results for the year ended December 31, 2005.

Since the Company's share in the earnings of associated companies constitutes a material component in the Company's statement of income (primarily on account of its share in the earnings of Mondi Business Paper Hadera ("Mondi Hadera") and Hogla-Kimberly ("H-K")), the Company also presents the aggregate data which include the results of all the companies in the AIPM group (including the associated companies whose results appear in the financial statements under "earnings from associated companies" (hereafter - the "Group")), net of intercompany sales and irrespective of the percentage of holding.

Aggregate Group sales in 2005 totaled NIS 2,784.8 million compared with NIS 2,626.2 million in 2004.

Aggregate operating profit in 2005 totaled NIS 117.5 million compared with NIS 143.5 million in 2004.

The aggregate operating income figures for 2005 include a provision for doubtful debts in the amount of NIS 10.6 million, that was recorded in 2005 at H-K on account of the collapse of one of its customers, the Club Market retail chain.

The erosion in the aggregate operating income in 2005 originated primarily from the extraordinary rise in input prices, as stated below, for which it was impossible to fully compensate by raising selling prices, due to the prevailing business conditions.

The consolidated data below does not include the results of operations of Mondi Hadera, H-K, Carmel Container Systems and TMM Integrated Recycling industries, which are included in the Company's share in results of associated companies.

Consolidated sales in 2005 totaled NIS 482.5 million compared with NIS 482.9 in 2004 and NIS 465.1 million in 2003.

Operating profit in 2005 totaled NIS 47.8 million compared with NIS 53.9 million in 2004 and NIS 46.6 million in 2003.

Net profit in 2005 amounted to NIS 45.7 million, as compared with NIS 62.7

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million in 2004 and NIS 60.0 million in 2003.

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

Net profit in 2004 included a tax benefit in the amount of NIS 10.2 million (including the Company's share in the benefit of associated companies) originating from the lowering of the tax rate, that entered into effect in June 2004. Moreover, a tax benefit of NIS 4.2 million was recorded in 2004, on account of the exercise of options by employees.

Net profit before non-recurring items amounted to NIS 37.7 million in 2005, as compared with NIS 48.3 million in 2004 and NIS 57.4 million in 2003.

Earnings per share (EPS) in 2005 totaled NIS 11.27 compared with NIS 15.44 in 2004 and NIS 14.94 in 2003.

The inflation rate in 2005 was 2.4% as compared with an inflation rate of 1.2% last year.

The exchange rate of the NIS was devaluated against the U.S. dollar in 2005 by 6.8% as compared with a revaluation of 1.6% last year.

Mr. Avi Brener Chief Executive Officer of the Company said that the year 2005 was characterized by an economic growth (approximately 5%), increased demand on the part of the public sector and more moderate growth in private consumption.

The Group's results in 2005 were significantly affected by the unusual rise in energy prices that began in 2004 and accelerated in 2005. This price increase included fuel oil and diesel prices that rose by an extraordinary average of 38% in relation to 2004. Water and electricity prices also rose in 2005 as compared with 2004 (by an average of 10% and 13%, respectively). The impact of these price increases on the Group's aggregate operating profit results amounts to approximately NIS 40 million.

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

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

In view of these market conditions and the fierce competition which the Group is facing, and with the intention of dealing with the increase in input prices, the Group accelerated its efficiency programs at all the companies, operating

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intensively to cut costs across all expense areas - while maintaining the quality of products and market share.

The Company's share in the earnings of associated companies (before non-recurring items) amounted to NIS 12.6 million in 2005, as compared with NIS 20.7 million in 2004 and NIS 35.5 million in 2003.

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

- The Company's share in the net earnings of Mondi Hadera (49.9%) decreased by NIS 10.1 million in 2005, as compared with 2004. Most of the change in profit in 2005 as compared with 2004 originates from the decrease in operating income between the years, as a result of the rebuild that was carried out on the paper machine in 2005. The unusual increase in raw material, energy and water prices also adversely affected the profitability of Mondi Hadera. The economic slowdown in Europe and the surplus of paper led to an erosion of imported paper prices and rendered it difficult for Mondi Hadera to raise prices, as warranted from the said price hikes - both in local markets and especially in export markets. Mondi Hadera is nevertheless continuing with its efforts to raise prices (in parallel to announcing higher prices in Europe in late 2005) and is intensifying its efficiency and cost-cutting measures.
- The Company's share in the net earnings of H-K (49.9%) increased by NIS 2.9 million in 2005, as compared with 2004. The stronger marketing operations and the fortification of brands, in combination with the increase in prices and effective efficiency measures, served to compensate in 2005 for the sharp rise in input prices (raw materials and energy) and improved the operating income. A net loss of NIS 3.5 million was recorded in the second quarter of 2005 on account of AIPM's share in a supplemental provision for doubtful debts, that was recorded by H-K on account of the debts of Club Market, that is undergoing a settlement of debts.
- The Company's share in the losses of Kimberly Clark Turkey, a wholly-owned Hogla-Kimberly subsidiary that is consolidated in its financial statements (hereinafter: "KCTR", formerly "Ovisan") (49.9%) has decreased by NIS 6.6 million in 2005, as compared with 2004. In 2005, KCTR has continued its preparation for the expansion of operations in the Turkish market and for the introduction of Kimberly Clark's international premium products into that market, as part of the multi-annual program (that is being formulated in conjunction with Kimberly Clark). In this capacity, the local management team was reinforced, to enable the realization of the said plan. KCTR has started the introduction of the Kotex(R) line of feminine hygiene products in late 2005 and is expected to introduce Huggies(R) diapers in 2006. KCTR recorded a significant loss in 2004, since the deployment of its distribution network on the one hand, and fierce competition in the Turkish market, on the other hand, resulted in the need to adjust the value of inventories to the prevailing market prices at the end of that year.
- The Company's share in the net earnings of the Carmel Group (26.25%) decreased by NIS 2.8 million in 2005 as compared with 2004. The change in 2005 originated from a decrease in operating profit and a rise in financial expenses (due to devaluation differentials). The decrease in operating profit, despite the quantitative increase in sales, originated primarily from the sharp rise in raw material prices, that was only

partially offset by the rise in selling prices (in view of the escalating competition in the corrugators market), leading to a consequent erosion in the gross margin. In 2005, Carmel began making

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investments as part of the strategic move to improve the corrugation base with the intention of rendering the manufacturing process more efficient. At the end of this process, the output capacity will reach 100 thousand tons. The investment will be completed in 2006.

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

In August 2005, the Company announced the distribution of a dividend for 2005, in the amount of NIS 50 million (NIS 12.5 per share). The dividend was paid in September 2005.

In December 2005, the Company announced the distribution of additional dividend for 2005, in the amount of NIS 50 million (NIS 12.494 per share). The dividend was paid in January 2006.

A total of 5,531 shares were issued in 2005 (0.1% dilution), on account of the exercise of 16,282 option warrants as part of the Company's employee stock option plans.

The Chairman of the Board, Mr. Yaki Yerushalmi, announced on 6 March 2006 his intention to retire, after 37 years of work at AIPM, of which 10 years as General Manager of Hogla, 17 years as the CEO of AIPM and 5 years as chairman of the AIPM group. The date of the retirement will be coordinated with the Board in order to enable a smooth succession.

This report contains various forward-looking statements based upon the Board of Directors' present expectations and estimates regarding the operations and plans of the Group and its business environment. The Company does not guarantee that the future results of operations will coincide with the forward-looking statements and these may in fact differ considerably from the present forecasts as a result of factors that may change in the future, such as changes in costs and market conditions, failure to achieve projected goals, failure to achieve anticipated efficiencies and other factors which lie outside the control of the Company. The Company undertakes no obligation for publicly updating the said forward-looking statements, regardless of whether these updates originate from new information, future events or any other reason.

AMERICAN ISRAELI PAPER MILLS LTD.
SUMMARY OF RESULTS
(AUDITED)
NIS IN THOUSANDS
except per share amounts

| 2005 | 2004 |
|-------|-------|
| ===== | ===== |

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| | | |
|--------------------|------------|------------|
| Net sales | 482,461 | 482,854 |
| Net earnings | 45,715 (1) | 62,732 (2) |
| Earnings per share | 1,127 (1) | 1,544 (2) |

- (1) The net earnings in 2005 include a non-recurring tax benefit in the sum of about NIS 8 million on account of the 2005 tax rate reduction in Israel (including the Company's share in the tax benefit of the associated companies).
- (2) The net earnings in 2004 include NIS 10.2 million, tax benefit resulting from the tax rate reduction last year (including the Company's share in the tax benefit of the associated companies), and an additional tax benefit of 4.2 millions on account of the exercise of employees option.

The representative exchange rate at December 31, 2005 was NIS 4.603=\$1.00

(sec-pres-11358)

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EXHIBIT 2

March 7, 2006

MANAGEMENT DISCUSSION

We are honored to present the consolidated financial statements of the American Israeli Paper Mills Ltd. ("AIPM" or the "Company") for the year 2005. The Company, its subsidiaries and associated companies - the "Group".

A. A DESCRIPTION OF THE GROUP'S BUSINESS

1. GENERAL

AIPM deals in the manufacture and sale of packaging paper, in the recycling of paper waste and in the marketing of office supplies - through subsidiaries. The Company also holds associated companies that deal in the manufacture and marketing of fine paper, in the manufacture and marketing of household paper products, hygiene products, disposable diapers and complementary kitchen products, corrugated board containers, packaging for consumer goods and the handling of solid waste.

The company's securities are traded on the Tel Aviv Stock Exchange and on the American Stock Exchange. (AMEX).

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2. THE BUSINESS ENVIRONMENT

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

The Group's results in 2005 were significantly affected by the unusual rise in energy prices, that began in 2004 and accelerated in 2005. This price increase included fuel oil and diesel prices that rose by an extraordinary average of 38% in relation to 2004. Water and electricity prices also rose in 2005 as compared with 2004 (by an average of 10% and 13%, respectively).
THE IMPACT OF THESE PRICE INCREASES ON THE GROUP'S AGGREGATE OPERATING PROFIT RESULTS AMOUNTS TO APPROXIMATELY NIS 40 MILLION.

In parallel, the prices of the principal raw materials used by the Group companies in their various activities also continued to rise. THE IMPACT IS AN ADDITIONAL NIS 60 MILLION TO THE GROUP'S COSTS IN THE AGGREGATED OPERATIONS PROFIT, COMPARED WITH 2004.

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

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

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

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

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

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imports and local manufacturers.

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

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

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

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

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

The Company is initially preparing for the conversion of its energy-generation systems from the use of fuel oil to natural gas, once the transportation infrastructure of natural gas to Hadera is completed. The transition is planned for the second half of 2006, subject to the arrival of the gas to Hadera.

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

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

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

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

B. RESULTS OF OPERATIONS

1. AGGREGATE DATA

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Since the Company's share in the earnings of associated companies constitutes a material component in the Company's statement of income (primarily on account of its share in the earnings of Mondi Business Hadera Paper Ltd. (Mondi Hadera) and Hogla-Kimberly Ltd.), the aggregate data appearing below include the results of all the companies in the AIPM Group (including the associated companies whose results appear in the financial statements under "earnings from associated companies"), without considering the rate of holding and net of mutual sales.

The aggregate sales amounted to NIS 2,784.8 million in 2005, as compared with NIS 2,626.2 million in 2004.

The aggregate operating income in 2005 amounted to NIS 117.5 million, as compared with NIS 143.5 million in 2004.

The aggregate operating income figures for 2005 include a provision for doubtful debts in the amount of NIS 10.6 million, that was recorded this year at Hogla Kimberly on account of the collapse of one of its customers, the Club Market retail chain.

The erosion in the aggregate operating income in 2005 originated primarily from the extraordinary rise in input prices, as stated above, for which it was impossible to fully compensate by raising selling prices, due to the prevailing business conditions.

2. CONSOLIDATED DATA

Excluding the results of operations of the associated companies: Mondi Hadera, Hogla-Kimberly, Carmel and TMM.

The sales amounted to NIS 482.5 million in 2005, as compared with NIS 482.9 million in 2004 and NIS 465.1 million in 2003.

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The total sales of the paper and recycling segment amounted to NIS 368.9 million, NIS 367.4 million and NIS 332.1 million in the years 2005, 2004 and 2003 respectively.

The gross profit of the paper and recycling segment amounted to NIS 69.8 million (19% of turnover), NIS 77.1 million (21% of turnover) and NIS 67.5 million (20% of turnover), respectively.

The total sales of the office supplies segment amounted to NIS 113.6 million, NIS 115.5 million and NIS 133.0 million in the years 2005, 2004 and 2003, respectively. The gross profit of the office supplies segment amounted to NIS 29.4 million (26% of turnover), NIS 29.9 million (26% of turnover) and NIS 35.4 million (27% of turnover), respectively.

The operating profit in 2005 amounted to NIS 47.8, as compared with NIS 53.9 million in 2004 and NIS 46.6 million in 2003.

3. NET PROFIT AND EARNINGS PER SHARE

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The net profit in 2005 amounted to NIS 45.7 million, as compared with NIS 62.7 million in 2004 and NIS 60.0 million in 2003.

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

The net profit in 2004 included a tax benefit in the amount of NIS 10.2 million (including the Company's share in the benefit of associated companies) originating from the change in deferred taxes on account of the lowering of the tax rate, that entered into effect in June 2004. Moreover, a tax benefit of NIS 4.2 million was recorded in 2004, on account of the exercise of options by employees.

The net profit before non-recurring items amounted to NIS 37.7 million in 2005, as compared with NIS 48.3 million in 2004 and NIS 57.4 million in 2003.

The Earnings Per Share in 2005 amounted to NIS 1,127 per NIS 1 par value (\$2.45 per share), as compared with NIS 1,544 per NIS 1 par value (\$3.58 per share) in 2004 and NIS 1,494 per NIS 1 par value (\$3.41 per share) in 2003.

The return on shareholders' equity amounted to 7.9% in 2005, as compared with 10.2% in 2004.

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C. ANALYSIS OF OPERATIONS AND PROFITABILITY

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

1. SALES

The consolidated sales amounted to NIS 482.5 million in 2005, as compared with NIS 482.9 million in 2004 and NIS 465.1 million in 2003.

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

The growth in sales in 2004, as compared with 2003, is attributed to a quantitative increase in packaging paper and in the sale of paper waste to external entities, coupled with an improvement in the prices of fluting and paper waste and a change in the sales mix. On the other hand, the decrease in Graffiti sales served to offset part of this growth.

2. COST OF SALES

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The cost of sales amounted to NIS 383.2 million in 2005, representing 79.4% of sales, as compared with NIS 375.9 million, or 77.9% of sales in 2004 and as compared with NIS 362.2 million, or 77.9% of sales in 2003.

The gross margin amounted to 20.6% in 2005, as compared with 22.1% in 2004 and 2003.

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

The Company managed to preserve its gross margin in 2004, as compared with 2003, despite the following rise in average input prices in 2004 as compared with 2003: Raw materials (paper waste by approximately 13%), energy (by approximately 4%) and water (by approximately 5%), accomplished through an increase in sales, higher selling prices and efficiency measures across all areas of operation.

Labor Wages

The labor wages in the cost of sales, in selling expenses and in General and Administrative expenses, amounted to NIS 149.7 million in 2005, as compared with NIS 143.5 million in 2004 and NIS 137.0 million in 2003.

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

3. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The selling, general and administrative expenses (including wages) amounted to NIS 51.5 million in 2005, 10.7% of sales, as compared with NIS 53.0 million, 11.0% of sales, in 2004 and NIS 56.3 million in 2003 (12.1% of sales).

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

4. OPERATING PROFIT

The operating profit amounted to NIS 47.8 million in 2005, representing 9.9% of sales, as compared with NIS 53.9 million, or 11.2% of sales in 2004 and as compared with NIS 46.6 million, or 10.0% of sales in 2003.

The decrease in the operating profit in the paper and recycling sector in 2005 as compared with 2004 originated primarily from the said

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erosion of margins, due to the sharp rise in input prices (primarily energy, electricity and water) on the one hand, along with the difficulty in raising prices - as warranted by the said rise in input prices - due to competing imports.

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

5. FINANCIAL EXPENSES

The financial expenses amounted to NIS 12.5 million in 2005, as compared with NIS 13.1 million in 2004 and NIS 16.0 million in 2003.

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

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

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

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

The financial reporting in 2003 was adjusted to the US dollar. The significant revaluation that year (7.6%) served to increase the Company's NIS-denominated

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liabilities in dollar terms, thereby leading the company to report higher financial expenses in 2003.

6. TAXES ON INCOME

Expenses for taxes on income from current operations totaled NIS 10.2 million in 2005, as compared with NIS 13.2 million in 2004 and NIS 8.8 million in 2003.

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

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A tax benefit of NIS 4.2 million was recorded in 2005 on account of the impact of the tax reforms that were passed by the Knesset in July this year (gradually lowering the corporate tax rate to 25% by 2010) on the company's deferred taxes. The financial statements in 2004 included a tax benefit of NIS 5.8 million on account of the impact of the change in the corporate tax rate that was passed in 2004 on the company's deferred taxes, coupled with an additional tax benefit of NIS 4.2 million on account of the exercise of options by employees. The tax expenses, including the said benefits, amounted to NIS 6.0 million in 2005, as compared with NIS 3.2 million in 2004.

7. COMPANY'S SHARE IN EARNINGS OF ASSOCIATED COMPANIES

The companies whose earnings are reported under this item (according to AIPM's holdings therein), include primarily: Mondi Hadera, Hogla-Kimberly, Carmel and TMM.

The Company's share in the earnings of associated companies (before non-recurring items) amounted to NIS 12.6 million in 2005, as compared with NIS 20.7 million in 2004 and NIS 35.5 million in 2003.

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

- The Company's share in the net earnings of Mondi Hadera (49.9%) decreased by NIS 10.1 million in 2005, as compared with 2004 (2004 - gain, 2005 - loss) and by NIS 3.0 million in 2004 as compared with 2003. Most of the change in profit in 2005 as compared with 2004 originates from the decrease in operating income between the years, as a result of the rebuild that was carried out on the paper machine this year. The massive rebuild, that was intended to improve the output of the machine and the quality of the paper, necessitated discontinuing the manufacturing process during the rebuild and was accompanied by a subsequent learning curve, as is normal during such a significant project. The unusual increase in raw material, energy and water prices also adversely affected the profitability of Mondi Hadera. The economic slowdown in Europe and the surplus of paper led to an erosion of imported paper prices and rendered it difficult for Mondi Hadera to raise prices, as warranted from the said price hikes - both in local markets and especially in export markets. Mondi Hadera is nevertheless continuing with its efforts to raise prices (in parallel to

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announcing higher prices in Europe in late 2005) and is intensifying its efficiency and cost-cutting measures.

The Company's share in the net earnings of Hogla-Kimberly (49.9%) increased by NIS 2.9 million in 2005, as compared with 2004 and by NIS 1.2 million in 2004 as compared with 2003. The stronger marketing operations and the fortification of brands, in combination with the increase in prices and effective efficiency measures, served to compensate in 2005 for the sharp rise in input prices (raw materials and energy) and improved the operating income. Hogla-Kimberly continues to improve the quality

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of its products, while strengthening its brands, including Mollett Hearts toilet paper, Kotex hygiene products and Nikol (complementary kitchen products).

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

The Company's share in the losses of Kimberly Clark Turkey, a wholly-owned Hogla-Kimberly subsidiary that is consolidated in its financial statements (hereinafter: "KCTR", formerly "Ovisan") (49.9%) has decreased by NIS 6.6 million in 2005, as compared with 2004 and grew by NIS 19.7 million in 2004, as compared with 2003. In 2005, KCTR has continued its preparation for the expansion of operations in the Turkish market and for the introduction of Kimberly Clark's international premium products into the Turkish market, as part of the multi-annual program (that is being formulated in conjunction with Kimberly Clark). In this capacity, the local management team was reinforced, to enable the realization of the said plan. KCTR has started the introduction of the Kotex(R) line of feminine hygiene products in late 2005 and is expected to introduce Huggies(R) diapers in 2006. KCTR recorded a significant loss in 2004, since the deployment of its distribution network on the one hand, and fierce competition in the Turkish market, on the other hand, resulted in the need to adjust the value of inventories to the prevailing market prices at the end of that year.

- The Company's share in the net earnings of the Carmel Group (26.25%) decreased by NIS 2.8 million in 2005 as compared with 2004 while in 2004 increased by NIS 3.6 million as compared with 2003. The change in 2005 originated from a decrease in operating profit and a rise in financial expenses (due to devaluation differentials). The decrease in operating profit, despite the quantitative increase in sales, originated primarily from the sharp rise in raw material prices, that was only partially offset by the rise in selling prices (in view of the escalating competition in the corrugator market), leading to a consequent erosion in the gross margin. In 2005, Carmel began making investments as part of the strategic move to improve the corrugation base with the intention of rendering the manufacturing process more efficient. At the end of this process, the output

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capacity will reach 100 thousand tons. The investment will be completed in 2006.

- The Company's share in the net earnings of TMM (43.08%) decreased by NIS 4.6 million in 2005 as compared with 2004 (2004 - gain, 2005 - loss); In 2004 the Company's share increased by NIS 1.4 million as compared with 2003. TMM recorded a sharp decrease in operating profit in 2005 as compared with 2004, due to the

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significant rise in transportation costs (originating from a significant average rise of 32% in diesel prices as compared with 2004 - an impact of NIS 8 million). This unusual increase in diesel prices was not sufficiently compensated for in the selling prices, due to the fact that most of the agreements are linked to the Consumer Price Index (CPI), that rose by only 2.4% this year. TMM is intensively carrying out efficiency measures and is attempting to modify some of the agreements, so as to reflect the extraordinary increase in diesel prices. We note that some of the customers began responding to the price changes in late 2005.

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

D. ANALYSIS OF THE COMPANY'S FINANCIAL SITUATION

- o Short-term investments decreased from NIS 62.5 million on December 31, 2004 to NIS 11.4 million on December 31, 2005. The decrease in this item originated from the realization of short-term deposits that was made, inter alia, due to the decrease in interest rates.
- o Accounts receivable rose from NIS 143.3 million on Dec 31, 2004 to NIS 150.4 million on December 31, 2005. This increase originates primarily from proceeds that were expected in December 2005 and were received in January 2006, coupled with a certain increase in days of credit.
- o Inventories rose from NIS 62.4 million on December 31, 2004 to NIS 64.0 million on December 31, 2005. The inventories represent current operating levels.
- o Investments in associated companies decreased from NIS 431.2 million on December 31, 2004 to NIS 429.0 million on December 31, 2005. The principal components of this decrease were the company's share in the net income of associated companies in 2005, net of dividends received from these companies.
- o Short-term credit decreased from NIS 112.7 million on December 31, 2004 to NIS 93.2 million on December 31, 2005. The decrease in this item originated from the positive net cash flows balance in 2005.
- o The other payables item rose from NIS 65.8 million on December 31, 2004 to NIS 85.4 million on December 31, 2005. On account of an increase in the balance of current taxes in 2005 and an increase in the employee balance originating primarily from the timing of the payment of the December paycheck over the years.
- o The decrease in net deferred taxes, from NIS 40.7 million on December 31, 2004, to NIS 33.0 million on December 31, 2005, originated primarily from the impact of the change in the corporate tax rate in 2005, in the sum of NIS 4.2 million.

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- o The Company's shareholders' equity decreased from NIS 575.3 million on December 31, 2004 to NIS 523.0 million on December 31, 2005. The change originates primarily from the net income on the one hand and the dividend payment, on the other hand.

E. LIQUIDITY AND INVESTMENTS

1. CASH FLOWS

The cash flows from operating activities in 2005 (excluding dividend from an associated company) amounted to NIS 66.8 million, as compared with NIS 47.1 million in 2004 (including the dividend received from an associated company, the cash flows in 2005 amounted to NIS 88.6 million). The improvement in the cash flows from operating activities in 2005 originated primarily from a decrease in working capital. The cash flows from operating activities (excluding dividend from an associated company) amounted to NIS 36.3 million in 2003 (including the dividend received from an associated company, the cash flows amounted to NIS 52.7 million).

The dividend that was declared in December 2005, in the amount of NIS 50 million, was paid in January 2006.

2. INVESTMENTS IN FIXED ASSETS

The investments in fixed assets amounted to NIS 78.1 million in 2005, as compared with NIS 31.0 million in 2004 and included investments in real estate in Hadera and Nahariya, in the amount of NIS 36.3 million, including buildings. The land that was acquired in 2005 in Hadera is agricultural land covering 21.5 acres, adjacent to the company's plant in Hadera. The land was acquired for NIS 20 million (approx. \$4.4 million) as a reserve for the Company's future development.

The investments in fixed assets in 2005 also included mainly investments in storage and compaction containers, presses, machinery, equipment and transportation means.

3. FINANCIAL LIABILITIES

The long-term liabilities (including current maturities) amounted to NIS 267.4 million as at December 31, 2005, as compared with NIS 267.9 million as at December 31, 2004.

The long-term liabilities include primarily two series of debentures: Series 1 - NIS 27.4 million, for repayment until 2009. Series 2 - NIS 207.2 million, for repayment between 2007 and 2013.

The balance of short-term credit, as at December 31, 2005, amounted to NIS 93.2 million, as compared with NIS 112.7 million at December 31, 2004.

The positive cash flows for the period and the repayment of deposits (due to the lower credit interest rate) served for financing the investments in fixed assets, for the payment of NIS 50 million in dividends in September this year and for the reduction of short-term credit.

F. EXPOSURE AND MANAGEMENT OF MARKET RISKS

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

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

Mr. Israel Eldar, the Company's Controller, is in charge of the management of market risks. He conducts calculations of the Company's exposure every month and examines the compliance with the policy determined by the Board of Directors.

Furthermore, limited use is made of derivative financial instruments, which the Company employs for hedging the cash flows, originating from the existing assets and liabilities. Such transactions are conducted primarily through currency options and forward transactions opposite Israeli banking institutions. The Company therefore believes that the inherent credit risk of these transactions is slight.

The Company possesses CPI-linked long-term loans (bonds) in the total sum of NIS 235 million, with the interest thereupon being no higher than the market interest rate. In the event that the inflation rate shall rise significantly, a loss may be recorded in the Company's financial statements, due to the surplus of CPI-linked liabilities.

In order to hedge this exposure, the Company has entered into forward transactions, as at December 31, 2005, for hedging NIS 230 million against a rise in the CPI until December 2006. These transactions serve to replace hedging transactions of NIS 200 million, that terminated in late 2005.

Credit Risks

Most of the Group's sales are made in Israel to a large number of customers and the exposure to customer-related credit risks is consequently generally limited. The Group regularly analyzes - through credit committees that operate within the various companies - the quality of the customers, their credit limits and the relevant collateral required, as the case may be.

The financial statements include provisions for doubtful debts, based on the existing risks on the date of the statements.

REPORT OF LINKAGE BASES

Below are the balance sheet items, according to linkage bases, as at December 31, 2005:

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| IN NIS MILLIONS | UNLINKED | CPI-LINKED | IN FOREIGN CURRENCY, OR LINKED THERETO (PRIMARYLY US\$) | NON-MONE ITEMS |
|---|---------------|----------------|---|----------------|
| ASSETS | | | | |
| CASH AND CASH EQUIVALENTS | 2.6 | | 5.7 | |
| SHORT-TERM DEPOSITS AND INVESTMENTS | 11.4 | | | |
| OTHER ACCOUNTS RECEIVABLE | 189.9 | 0.2 | 55.3 | 11 |
| INVENTORIES | | | | 64 |
| INVESTMENTS IN ASSOCIATED COMPANIES | 63.1 | | 9.2 | 356 |
| DEFERRED TAXES ON INCOME | | | | 5 |
| FIXED ASSETS, NET | | | | 379 |
| DEFERRED EXPENSES, NET OF ACCRUED AMORTIZATION | | | | 1 |
| TOTAL ASSETS | 267.0 | 0.2 | 70.2 | 818 |
| LIABILITIES | | | | |
| SHORT-TERM CREDIT FROM BANKS AND FROM OTHERS | 93.2 | | | |
| ACCOUNTS PAYABLE | 214.1 | 0.9 | 11.0 | |
| DEFERRED TAXES ON INCOME | | | | 45 |
| NOTES (BONDS) - INCLUDING CURRENT MATURITIES | 234.6 | | | 234 |
| OTHER LIABILITY | 32.8 | | | |
| SHAREHOLDERS' EQUITY, FUNDS AND RETAINER EARNINGS | | | | 523 |
| TOTAL LIABILITIES AND EQUITY | 340.1 | 235.5 | 11.0 | 569 |
| SURPLUS FINANCIAL ASSETS (LIABILITIES) AS AT DECEMBER 31, 2005 | (73.1) | (235.3) | 59.2 | 249 |

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Below are the balance sheet items, according to linkage bases, as at December 31, 2004:

| IN NIS M | UNLINKED | CPI-LINKED | IN FOREIGN CURRENCY, OR | NON-MONE ITEMS |
|----------|----------|------------|-------------------------|----------------|
|----------|----------|------------|-------------------------|----------------|

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LINKED THERETO
(PRIMARILY US\$)

ASSETS

| | | | | |
|--|-------|------|------|-----|
| CASH AND CASH EQUIVALENTS | 3.3 | | 4.5 | |
| SHORT-TERM INVESTMENTS | 16.9 | 45.6 | | |
| OTHER ACCOUNTS RECEIVABLE | 192.0 | 1.8 | 43.6 | 7 |
| INVENTORIES | | | | 83 |
| INVESTMENTS IN ASSOCIATED COMPANIES | 49.3 | 10.7 | 8.6 | 362 |
| DEFERRED TAXES ON INCOME | | | | 6 |
| FIXED ASSETS, NET | | | | 324 |
| DEFERRED EXPENSES, NET OF ACCRUED AMORTIZATION | | | | 1 |
| TOTAL ASSETS | 261.5 | 58.1 | 56.7 | 785 |

LIABILITIES

| | | | | |
|---|-------|-------|------|-----|
| CREDIT FROM BANKS | 110.5 | | 2.2 | |
| ACCOUNTS PAYABLE | 142.3 | 1.0 | 10.1 | |
| DEFERRED TAXES ON INCOME | | | | 52 |
| NOTES (BONDS) | | 235.1 | | |
| OTHER LIABILITIES | 32.8 | | | |
| SHAREHOLDERS' EQUITY, FUNDS AND RETAINED EARNINGS | | | | 575 |
| TOTAL LIABILITIES AND EQUITY | 285.6 | 236.1 | 12.3 | 627 |

| | | | | |
|--|--------|---------|------|-----|
| SURPLUS FINANCIAL ASSETS (LIABILITIES) AS AT DECEMBER 31, 2004 | (24.1) | (178.0) | 44.4 | 157 |
|--|--------|---------|------|-----|

ASSOCIATED COMPANIES

AIPM is exposed to various risks associated with operations in Turkey, where Hogla-Kimberly is active through its subsidiary, KCTR. These risks originate from concerns regarding economic instability and elevated interest rates, that characterized the Turkish economy in the past and that may recur and harm the KCTR operations.

G. FORWARD-LOOKING STATEMENTS

This report contains various forward-looking statements, based upon the Board of Directors' present expectations and estimates regarding the operations of the Group and its business environment. The Company does not guarantee that the future results of operations will coincide with the forward-looking statements and these may in fact considerably differ from the present forecasts as a result of factors that may change in the future, such as changes in costs and market conditions, failure to achieve projected goals, failure to achieve anticipated efficiencies and other factors which lie outside the control of the company. The Company

undertakes no obligation to publicly update such forward-looking statements, regardless of whether these updates originate from new information, future events or any other reason.

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H. DONATIONS AND CONTRIBUTIONS

The AIPM Group, within the framework of its business and social commitment, invests efforts and funds in community assistance and support, while focusing on providing help to the weaker echelons of Israeli society - and primarily teenagers - as part of a desire to build and contribute to shaping the human fabric of Israeli society.

As part of this policy, the company makes contributions to various institutions active in the said areas. The Group's contributions amounted to NIS 200 thousand in 2005. In parallel, the Company also participates in volunteer activity in the community through its employees, for promoting these same objectives.

Moreover, a sum totaling NIS 105 thousand was granted for student scholarships and for the project this year, through the Shenkar Foundation, that was established by the company together with its Austrian strategic partner in Mondri Hadera.

I. MEMBERS OF THE BOARD OF DIRECTORS POSSESSING FINANCIAL SKILLS AND

QUALIFICATIONS

The minimum number of Company directors possessing accounting and financial qualifications and skills was determined to be two for the company, in consideration of the nature of the accounting and financial issues that are raised in the preparation of the Company's financial statements, in view of the Company's areas of operation and in consideration of the composition of the board of directors as a whole, that includes individuals possessing business, management and professional experience that enables them to deal effectively with the tasks of managing the Company, including reporting duties.

The members of the Company's board of directors who possess accounting and financial qualifications and skills are:

- | | |
|-----------------|--|
| Nochi Dankner - | Chairman of the Board of Directors and CEO of IDB Holding Corporation Ltd. Chairman of the Board of Directors of IDB Development Company Ltd., Discount Investments Ltd. and Clal Industries and Investments Ltd. Serves or has served in the past as Chairman of the Board of Directors and Director in publicly-traded and privately-held companies in the Ganden Group, IDB Group, as well as at Bank Hapoalim, where he served as Chairman of the Board of Directors' Credit Committee. Holds a degree in Law. |
| Avi Yehezkel - | Holds a degree in economics. External directorat Bank Yahav. Served as a Knesset member between 1992-2003, also served as Chairman of the |

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Economics Committee, Chairman of the Defense Budget Committee, Chairman of the Capital Market Sub-Committee, Chairman of the Banking Sub-Committee and member of the Finance Committee.

Oren Lieder - Holds a degree in economics and statistics. Serves as Senior VP and CFO of Discount Investments Ltd. Serves as director at various companies, including publicly-traded companies. Formerly served as CFO of Bezeq, the Israeli Telecom Company Ltd.

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Isaac Manor - Holds an MBA. Serves as director at various publicly-traded and privately-held companies within the IDB Group; Chairman of companies in the David Lubinsky Group Ltd.; member of the Accounts Committee at Israel Union Bank Ltd.

Amos Mar-Haim - Holds a first degree in economics and an MBA from Hebrew University. Formerly served and currently serves as Chairman or Deputy Chairman at publicly-traded or privately-held companies. Member of the Israeli Accounting Standards Board.

Amir Makov - Holds a degree in law and in engineering. Served as CEO of Haifa Chemicals Ltd., Sonol Israel Ltd.. Served and serves as a director of various publicly-traded and privately-held companies including Bank Leumi Ltd., Dead Sea Works Ltd., Granite Hacarmel Ltd.

H. THE COMPANY'S INTERNAL AUDITOR

-
- i. Auditor's Name: Lenny Siegel
In the position since: 1996
Credentials: CPA, CA Canadian
 - ii. The Auditor is employed by the Company.
 - iii. Scope of employment: Full-time job as Auditor, plus an assistant.
 - iv. The considerations in determining the current and the multi-annual audit plan at the Company's: The current auditing program is based on a five-year program that covers numerous topics approved by the Audit Committee, pursuant to the auditing requirements of the company and encompasses issues that the Internal Auditor believes warrant his inspection and attention in the course of the current year, subject to the approval of the Audit Committee and the law.
 - v. The Internal Auditing program includes auditing topics in corporations that constitute significant holdings of the Company.
 - vi. The Internal Auditor conducts the audit according to generally-accepted professional standards of internal auditing in Israel and worldwide.
 - vii. The Internal Auditor is supervised by the General Manager.

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viii. Audit reports were submitted and discussed at the following dates:

| SUBMITTED | DISCUSSED |
|-----------|-----------|
| 6.3.05 | 10.3.05 |
| 5.5.05 | 10.5.05 |
| 4.8.05 | 9.8.05 |
| 6.11.05 | 9.11.05 |

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ix. The scope of employment of the Internal Auditor is determined according to a cycle that renders it possible to audit all the significant topics at the Company, once every few years. This scope of activity, the nature, the continuity of operation and the work plan of the Internal Auditor - are reasonable - according to the estimation of the Company's Audit Committee, while rendering it possible to realize the Internal Audit objectives of the organization. The Company declares that it has granted the Internal Auditor free, constant and direct access to all the information at its disposal.

J. PEER GROUP SURVEY

The Israeli Securities Authority published a directive based on Section 36a of the Securities Law (1968) on July 28th 2005, regarding disclosure pertaining to the granting of agreement to conduct a peer group survey whose objective is - according to the said directive - to put in motion a process whereby the auditing process performed by the firms will be controlled, to contribute to the existence of an advanced capital market. The Company's Board of Directors views this as a positive process, although the process itself raises several issues, including legal issues, that have yet to be resolved and that are related, inter alia, to safeguarding the confidential information belonging to the Company and the Group companies, to prevent conflicts of interest and to promote responsibility for damages that may be incurred in relation to the process. The Company's Board of Directors has therefore agreed, in principle, to cooperate in this process, pursuant to a satisfactory resolution of the various issues that have yet to be resolved, as stated above.

The general meeting of shareholders was held on June 28th 2005, prior to the publication of the directives.

K. INDEPENDENT AUDITOR FEES

Current Fees

The professional fees for the Company's independent auditor covering auditing services, services related to auditing and tax services, amounted to \$120 thousand in 2005, similar to 2004.

Additional services

The Company's independent auditor provided additional services in 2005, related to consulting and guidance regarding the establishment of processes pursuant to Section 404 of the Sarbanes Oxley Act in the USA, in return for

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which a fee of \$30 thousand was paid.

L. GENERAL

- o In August 2005, the Company announced the distribution of a dividend for 2005, in the amount of NIS 50 million (NIS 12.5 per share). The dividend was paid in September 2005.
- o In December 2005, the Company announced the distribution of additional dividend for 2005, in the amount of NIS 50 million (NIS 12.494 per share). The dividend was paid in January 2006.

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- o 5,531 shares were issued in 2005 (0.1% dilution), on account of the exercise of 16,282 option warrants as part of the Company's employee option plans.
- o The company acquired a land plot of 21.5 acres in 2005, adjacent to its Hadera plant, in return for \$4.4 million.
- o In July 2005, Carmel Container Systems Ltd. - an associated company - completed its delisting process from the American Stock Exchange.
- o The Chairman of the Board, Mr. Yaki Yerushalmi, announced on 6 March 2006 his intention to retire after 37 years of work at AIPM, of which 10 years as General Manager of Hogla, 17 years as the CEO of AIPM and 5 years as chairman of the AIPM group. The date of the retirement will be coordinated with the Board in order to enable a smooth succession. Mr. Yerushalmi expressed his gratitude to all who accompanied me along the way and contributed their share to the success of the group.

Y. Yerushalmi
Chairman of the Board of Directors

Avi Brenner
General Manager

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EXHIBIT 3

AMERICAN ISRAELI PAPER MILLS LIMITED
2005 CONSOLIDATED FINANCIAL STATEMENTS

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

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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 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. 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 7, 2006

AMERICAN ISRAELI PAPER MILLS LIMITED
CONSOLIDATED BALANCE SHEETS

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

ASSETS

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| | | |
|-------------------------------------|--------|-----------|
| CURRENT ASSETS: | 8 | |
| Cash and cash equivalents | 1o | 8,318 |
| 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 |
| |) |
| ----- |) CHIEF EXECUTIVE OFFICER |
| AVI BRENER |) |
| |) |
| ----- |) CONTROLLER |
| ISRAEL ELDAR |) |

Date of approval of the financial statements: March 7, 2006

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LIABILITIES AND SHAREHOLDERS' EQUITY

| | | |
|--|-----|-----------|
| 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

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| | | NIS |
|---|--------|---------|
| | | ----- |
| SALES - net | 10f;14 | 482,461 |
| COST OF SALES | 10g | 383,179 |
| GROSS PROFIT | | 99,282 |
| SELLING, MARKETING, ADMINISTRATIVE 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 COMPANY AND ITS SUBSIDIARIES | | 29,301 |
| SHARE IN PROFITS OF ASSOCIATED COMPANIES - net | 2 | 16,414 |
| | | ----- |
| NET INCOME FOR THE YEAR | | 45,715 |
| | | ===== |
| | | ----- |
| NET INCOME PER NIS 1 OF PAR VALUE OF SHARES | 1p;11 | 1,127 |
| | | ===== |

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

| | |
|-----------|-----------|
| | DIFFERENC |
| | FROM |
| CAPITAL | TRANSLATI |
| SURPLUS | OF |
| RESULTING | FOREIGN |

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| | SHARE CAPITAL ----- | CAPITAL SURPLUSES ----- | FROM TAX BENEFIT ON EXERCISE OF EMPLOYEE OPTIONS ----- | CURRENCY FINANCIAL STATEMENTS OF ASSOCIATED 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 into shares | 1 | | | |
| Differences from currency translation resulting from translation of financial 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 into shares | * | | | |
| Differences from currency translation resulting from translation of financial statements of associated companies | | | | (1,68 |
| BALANCE AT DECEMBER 31, 2004 | 125,257 | 90,060 | | (2,80 |
| CHANGES IN 2005: | | | | |
| Net income | | | | |
| Dividend ** | | | | |
| Exercise of employee options into shares | * | | 401 | |
| Differences from currency translation resulting from translation of financial statements of 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.

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AMERICAN ISRAELI PAPER MILLS LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | 2005 ----- | 2004 ----- |
|---|----------------------|---------------|
| | NIS IN THOUSANDS () | |
| | ----- | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income for the year | 45,715 | 62,732 |
| Adjustments to reconcile net income to 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 CASH EQUIVALENTS | 505 | (150,893) |
| BALANCE OF CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 7,813 | 158,706 |
| | ----- | ----- |
| BALANCE OF CASH AND CASH EQUIVALENTS AT END OF YEAR | 8,318 | 7,813 |
| | ===== | ===== |

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AMERICAN ISRAELI PAPER MILLS LIMITED
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) | (2,111) |
| Dividend received from associated company | 21,761 | 21,761 |
| Depreciation and amortization | 31,604 | 29,704 |
| 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) |
| | ----- | ----- |
| | 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 |
| | ===== | ===== |

2005

 NIS IN THOUSANDS
 (SEE NOTE 1B.)

| | | |
|-----|--|---------|
| (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

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

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

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

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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.

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- 7) In April 2005, the IASB issued Clarification No. 7 - "Accounting Treatment of the Tax Benefits, in Respect of Capital Instruments Granted to Employees, For Which No Compensation was Recognized". The provisions of this clarification apply to such tax benefits, which have not been allowed as a deduction through December 31, 2004. The clarification stipulates that, commencing on January 1, 2005, the tax benefit derived by the Company from the exercise of options granted to employees is to be carried to shareholders' equity, in the period in which the benefit to the employees is allowed as a deduction for tax purposes. Formerly, the aforesaid tax saving was credited to the statement of income, as part of the taxes on income item.

K. REVENUE RECOGNITION

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

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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.

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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

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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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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

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commencing on the effective date of the standard.

Until the publication of said standard and the 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 |
| | --- |
| | 356 |
| Long-term loans and capital notes * | 72 |
| | --- |
| | 428 |
| | === |

* Classified by linkage terms, the total amounts of the

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loans and capital notes are as follows:

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

** 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;

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formerly - Neusiedler Hadera Paper Ltd. - NHP):

Mondy Hadera is held to the extent of 49.9% by the 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.

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

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 BEGINNING OF YEAR | ADDITIONS DURING THE YEAR | RETIREMENTS DURING THE YEAR | BALANCE END 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 (including computers) | 68,362 | 2,073 | 269 | 70,1 |
| Payments on account of machinery and equipment | 13,166 | 4,166 | 2,165 | 15,1 |
| Spare parts - not current | 20,833* | 2,429 | | 23,2 |

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| | | | |
|---------|--------|-------|---------|
| 995,295 | 71,080 | 8,464 | 1,057,9 |
| ===== | ===== | ===== | ===== |

ACCUMULATED DEPRECIATION

| | BALANCE AT BEGINNING OF YEAR | ADDITIONS DURING THE YEAR | RETIREMENTS DURING THE YEAR | BALANCE END OF YEAR |
|---|------------------------------------|---------------------------------|-----------------------------------|---------------------------|
| ----- | | | | |
| 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 (including computers) | 54,760 | 2,610 | 68 | 57,3 |
| Payments on account of machinery and equipment | | | | |
| Spare parts - not current | | | | |
| | ----- | ----- | ----- | ----- |
| | 650,056 | 31,444 | 3,523 | 677,9 |
| | ===== | ===== | ===== | ===== |

*Reclassified.

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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 | | |
| | ----- | | |
| | 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:

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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 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 | 2005 ISSUED AND PAID UP |
|------------------|---------------------|----------------------------|
| | ----- | ----- |
| Number of shares | 20,000,000 ===== | 4,002,205 ===== |

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Amount in NIS

200,000

40,022

=====

=====

The shares are traded on stock exchanges in Tel-Aviv and in the U.S. ("AMEX"). The quoted prices per share, as of December 31, 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.

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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

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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.

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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.

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

NOTE 7 - TAXES ON INCOME (continued):

F. DEFERRED INCOME TAXES

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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 fixed assets | Inventories | Severance pay | Vacation and recreation pay | Do 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 |
| | ===== |

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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, 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 THOUSANDS | % | NIS THOU |
| | --- | ----- | --- | ----- |
| Income before taxes on income, as reported 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 for approved enterprises | ----- | ----- | ----- | --- |
| | 34.0 | 11,999 | 35.0 | 14 |
| Decrease in taxes resulting from computation of deferred taxes at a rate which is different from the theoretical rate | (0.9) | (324) | (4.3) | (1 |
| Decrease in taxes resulting from adjustment to deferred tax balances due to changes in tax rates, see d. above | (11.8) | (4,166) | (14.3) | (5 |
| Tax deduction in respect of options exercised by employees according to Section 102 of the Israeli Income Tax Ordinance (2005 - see note 1j(7)) | (4.3) | (1,518) | (10.3) | (4 |
| Other - net | (4.3) | (1,518) | 1.6 | |

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| | | | | |
|---------------------------------------|------------------------|-------------------------|-----------------------|---------------------|
| Taxes on income for the reported year | ----- 17.0 ===== | ----- 5,991 ===== | ----- 7.7 ===== | ----- 3 ===== |
|---------------------------------------|------------------------|-------------------------|-----------------------|---------------------|

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 TO, FOREIGN CURRENCY (MAINLY DOLLAR) | LINKED TO THE ISRAELI CPI | UNLINKED | IN, OR TO, F CUR (MAINLY |
| | NIS IN THOUSANDS | | | |
| | ----- | ----- | ----- | ----- |
| Assets: | | | | |
| Current assets: | | | | |
| 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 - long-term loans and capital notes | 9,206 | | 63,125 | 8,61 |
| | 70,253 | 167 | 267,031 | 56,74 |
| | ===== | ===== | ===== | ===== |
| Liabilities: | | | | |
| Current liabilities: | | | | |
| Short-term credit from banks | | | 93,171 | 2,23 |
| Accounts payables and accruals | 11,062 | 868 | 214,082 | 10,10 |
| Long-term liabilities (including current maturities): | | | | |
| Notes | | 234,638 | | |
| Other liability | | | 32,770 | |
| | 11,062 | 235,506 | 340,023 | 12,33 |
| | ===== | ===== | ===== | ===== |

As to exposures relating to fluctuations in foreign

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currency exchange rates and the use of derivatives for hedging purposes - see note 12a.

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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 ONE DOLLAR ----- NIS --- | CPI* ---- POINTS ----- |
|---------------------|---|---------------------------------|
| 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

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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 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:

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Employees and employee institutions
Associated companies - current debt
Prepaid expenses
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.

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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

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

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

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
=====

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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

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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):

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

The amounts presented above represent transactions that the Company carried out in the ordinary course of business with interested parties (companies which are held by the Company's principal shareholder), at terms and prices similar to those applicable to non-affiliated customers and suppliers.

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

*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.

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- 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 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.

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NOTE 14 - SEGMENT INFORMATION (continued):

B. BUSINESS SEGMENT DATA:

| | PAPER AND RECYCLING | | | MARKETING OF OFFICE SUPPLIES | | |
|--|---------------------|---------|---------|------------------------------|---------|---------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| | NIS IN THOUSANDS | | | | | |
| Sales - net(1) | 368,884 | 367,391 | 332,124 | 113,577 | 115,463 | 132,124 |
| Income (loss) from ordinary operations | 48,662 | 58,496 | 46,282 | (880) | (4,566) | 13,124 |
| 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 | 59,124 |
| 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* | 25,124 |
| 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 | 2,124 |

* 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 INDIRECT HOLDING CONFERRING E VOTING R ----- % |
|--|---|
| MAIN SUBSIDIARIES: | |
| 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. |
| MAIN ASSOCIATED COMPANIES: | |
| 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. | |

MONDI BUSINESS PAPER HADERA LTD.

FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2005

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Notes to the Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE SHAREHOLDERS OF

MONDI BUSINESS PAPER HADERA LTD.

We have audited the accompanying balance sheet of MONDI BUSINESS PAPER HADERA LTD. ("the Company") as of December 31, 2005 and 2004, and the consolidated balance sheets as of such dates, and the related statements of operations, changes in shareholders' equity and cash flows - of the Company and on a consolidated basis - for each of the two 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 audit. The financial statements of the Company and on a consolidated basis as of December 31, 2003 and for the year then ended were audited by other auditors whose report, dated March 10, 2004, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States) and with generally accepted auditing standards in Israel, including those prescribed by the Israeli Auditors' Regulations (Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are

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appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position - of the Company and on a consolidated basis - as of December 31, 2004 and 2005 and the results of operations, changes in shareholders' equity and cash flows - of the Company and on a consolidated basis - for each of the two years in the period ended December 31, 2005, in accordance with generally accepted accounting principles in Israel. In addition, in our opinion, the financial statements referred to above are prepared in accordance with the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

As explained in Note 2A, the financial statements as of dates and for reporting periods commencing January 1, 2004, are presented at reported amounts, in accordance with accounting standards of the Israeli Accounting Standards Board. The financial statements for the year ended December 31, 2003, have been prepared on the basis of historical cost adjusted for changes in the exchange rate of the U.S. dollar in relation to the NIS, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

BRIGHTMAN ALMAGOR & CO.
CERTIFIED PUBLIC ACCOUNTANTS

A MEMBER FIRM OF DELOITTE TOUCHE TOHMATSU

Tel Aviv, Israel
March 5, 2006

MONDI BUSINESS PAPER HADERA LTD.
BALANCE SHEETS
(NIS in thousands; Reported Amounts)

| | | CONSOLIDATED | |
|--|---------|--------------|---------|
| | | DECEMBER 31, | |
| NOTE | 2 0 0 5 | 2 0 0 4 | |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | 3 | - | 10,804 |
| Trade receivables | 4 | 160,875 | 157,815 |
| American Israeli Paper Mills Group, net | | - | - |
| Other receivables | 5 | 10,872 | 7,580 |
| Inventories | 6 | 116,859 | 90,391 |
| | | 288,606 | 266,590 |

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| | | | |
|--|----|---------|---------|
| LONG-TERM INVESTMENTS | | | |
| Investments in Subsidiaries | 7 | - | - |
| FIXED ASSETS | | | |
| Cost | 8 | 202,469 | 149,083 |
| Less - accumulated depreciation | | 43,132 | 33,345 |
| | | ----- | ----- |
| | | 159,337 | 115,738 |
| LONG -TERM ASSETS | | | |
| Goodwill | 7B | 3,177 | 3,800 |
| | | ----- | ----- |
| | | 3,177 | 3,800 |
| | | ----- | ----- |
| | | 451,120 | 386,128 |
| | | ----- | ----- |
| CURRENT LIABILITIES | | | |
| Short term bank credit | | 85,887 | - |
| Current maturities of long-term bank loans | 11 | 16,242 | 15,125 |
| Capital notes to shareholders | 12 | 18,412 | - |
| Trade payables | 9 | 102,984 | 104,661 |
| American Israeli Paper Mills Group, net | | 69,854 | 65,033 |
| Subsidiaries | | - | - |
| Other payables and accrued expenses | 10 | 20,202 | 23,132 |
| | | ----- | ----- |
| | | 313,581 | 207,951 |
| | | ----- | ----- |
| LONG-TERM LIABILITIES | | | |
| Long-term bank loans | 11 | 21,807 | 36,248 |
| Capital notes to shareholders | 12 | - | 17,233 |
| Deferred taxes | 21 | 19,900 | 25,422 |
| Accrued severance pay, net | 13 | 51 | 87 |
| | | ----- | ----- |
| | | 41,758 | 78,990 |
| | | ----- | ----- |
| COMMITMENTS AND CONTINGENT LIABILITIES | | | |
| SHAREHOLDERS' EQUITY | | | |
| Share capital | 15 | 1 | 1 |
| Premium | | 43,352 | 43,352 |
| Retained earnings | | 52,428 | 55,834 |
| | | ----- | ----- |
| | | 95,781 | 99,187 |
| | | ----- | ----- |
| | | 451,120 | 386,128 |
| | | ----- | ----- |

| | | |
|--------------------|-----------------|---|
| A. MAGID | A. SOLEL | Y. YERUSHALMI |
| Financial Director | General Manager | Vice Chairman of the Board of Directors |

Approval date of the financial statements: March 5, 2006.

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

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MONDI BUSINESS PAPER HADERA LTD.
STATEMENTS OF OPERATIONS
(NIS in thousands; except per share data)

| | NOTE | CONSOLIDATED | | | |
|---|------|-------------------------|----------------------|----------------------|----------------------|
| | | YEAR ENDED DECEMBER 31, | | | |
| | | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | | REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (2) | REPORTED AMOUNTS (1) |
| Net sales | 16 | 663,338 | 686,094 | 640,020 | 462,177 |
| Cost of sales | 17 | 609,752 | 605,738 | 556,890 | 420,558 |
| GROSS PROFIT | | 53,586 | 80,356 | 83,130 | 41,619 |
| Selling expenses | 18 | 45,268 | 46,135 | 42,892 | 35,924 |
| General and administrative expenses | 19 | 7,301 | 7,803 | 8,425 | 6,702 |
| OPERATING PROFIT (LOSS) | | 1,017 | 26,418 | 31,813 | (1,007) |
| Financing expenses, net | 20 | (12,868) | (8,438) | (2,561) | (11,533) |
| Other income (expenses), net | | 65 | 100 | (215) | - |
| INCOME (LOSS) BEFORE INCOME TAXES | | (11,786) | 18,080 | 29,037 | (12,540) |
| Income taxes (tax benefits) | 21 | (8,380) | 818 | 10,518 | (8,470) |
| INCOME (LOSS) AFTER INCOME TAXES (TAX BENEFITS) | | (3,406) | 17,262 | 18,519 | (4,070) |
| Equity in net earnings (losses) of Subsidiaries | | - | - | - | 664 |
| NET INCOME (LOSS) FOR THE YEAR | | (3,406) | 17,262 | 18,519 | (3,406) |
| EARNINGS (LOSS) PER SHARE (IN NIS) | | (3,406) | 17,262 | 18,519 | (3,406) |
| NUMBER OF SHARES | | | | | |

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MONDI BUSINESS PAPER HADERA LTD.
STATEMENTS OF CASH FLOWS
(NIS in thousands)

| | CONSOLIDATED | | | |
|---|-------------------------|-------------------------|-------------------------|------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR ENDED |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (2) | REPORTED AMOUNTS (1) | |
| CASH FLOWS - OPERATING ACTIVITIES | | | | |
| Net income (loss) for the year | (3,406) | 17,262 | 18,519 | (3,406) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities (Appendix A) | (29,625) | 20,295 | 37,698 | (28,359) |
| NET CASH PROVIDED BY (USED IN) | | | | |
| OPERATING ACTIVITIES | (33,031) | 37,557 | 56,217 | (31,765) |
| CASH FLOWS - INVESTING ACTIVITIES | | | | |
| Acquisition of fixed assets | (51,323) | (16,235) | (9,339) | (51,323) |
| Proceeds from sale of fixed assets | 248 | 197 | 635 | 184 |
| NET CASH USED IN INVESTING ACTIVITIES | (51,075) | (16,038) | (8,704) | (51,139) |
| CASH FLOWS - FINANCING ACTIVITIES | | | | |
| Short-term bank credit, net | 87,004 | - | (18) | 86,990 |
| Repayment of long-term bank loans | (13,702) | (15,265) | (21,116) | (13,702) |
| Repayment of long-term capital notes to shareholders | - | (27,128) | (43,790) | - |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 73,302 | (42,393) | (64,924) | 73,288 |
| INCREASE (DECREASE) IN | | | | |
| CASH AND CASH EQUIVALENTS | (10,804) | (20,874) | (17,411) | (9,616) |
| CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR | 10,804 | 31,678 | 49,089 | 9,616 |
| CASH AND CASH EQUIVALENTS - END OF YEAR | - | 10,804 | 31,678 | - |

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- (1) See Note 2A.
 (2) Adjusted for changes in the exchange rate of the U.S. dollar as of December 31, 2003.

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

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MONDI BUSINESS PAPER HADERA LTD.
 APPENDICES TO STATEMENTS OF CASH FLOWS
 (NIS in thousands)

| | CONSOLIDATED | | | |
|---|-------------------------|-------------------------|---------------------|----------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (2) | REPORTED AMOUNTS | |
| A. ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | | | | |
| INCOME AND EXPENSES ITEMS NOT INVOLVING CASH FLOWS: | | | | |
| Equity in net losses (earnings) of Subsidiaries | - | - | - | (664) |
| Depreciation and amortization | 10,722 | 9,118 | 8,626 | 9,617 |
| Deferred taxes, net | (8,470) | 823 | 10,438 | (8,470) |
| Increase (decrease) in liability for severance pay, net | (36) | (58) | 14 | (36) |
| Capital loss (gain) from sale of fixed assets | (65) | (100) | 215 | - |
| Effect of exchange rate and linkage differences of long-term bank loans and long-term loan to Subsidiary | (738) | (195) | 1,460 | (739) |
| Effect of exchange rate differences of long-term capital notes to shareholders | 1,179 | 571 | - | 1,179 |
| CHANGES IN ASSETS AND LIABILITIES: | | | | |
| Decrease (increase) in trade receivables | (3,060) | (10,067) | 7,247 | - |
| Decrease (increase) in other receivables | (345) | (932) | 752 | (3,165) |
| Decrease (increase) in inventories | (26,468) | (1,160) | (9,533) | (30,153) |
| Increase (decrease) in trade payables | (4,235) | (220) | 27,447 | 8,907 |
| Increase (decrease) in American Israeli Paper Mills | | | | |

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| | | | | |
|--|----------|--------|---------|----------|
| Group, net | 4,821 | 16,247 | (1,612) | 49,685 |
| Increase (decrease) in Subsidiaries | - | - | - | (53,426) |
| Increase (decrease) in other payables and accrued expenses | (2,930) | 6,268 | (7,356) | (1,094) |
| | ----- | ----- | ----- | ----- |
| | (29,625) | 20,295 | 37,698 | (28,359) |
| | ----- | ----- | ----- | ----- |
| B. NON-CASH ACTIVITIES | | | | |
| Acquisition of fixed assets on credit | 3,342 | 784 | - | 3,342 |
| | ----- | ----- | ----- | ----- |

(1) See Note 2A.

(2) Adjusted for changes in the exchange rate of the U.S. dollar as of December 31, 2003.

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

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF BUSINESS AND GENERAL

A. DESCRIPTION OF BUSINESS

Mondi Business Paper Hadera Ltd. ("the Company") was incorporated and commenced operations on January 1, 2000. The Company and its Subsidiaries are engaged in the production and marketing of paper, mainly in Israel.

The Company is presently owned by Neusiedler AG ("NAG" or the "Parent Company") (50.1%) and American-Israeli Paper Mills Ltd. ("AIPM") (49.9%).

In the framework of a change in the organizational structure of the Group, effective January 1, 2003, all marketing and selling activities of the Group, which until such date were performed by four Subsidiaries, were centralized to one Subsidiary with three logistic sites.

The financial statements are prepared in accordance with the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

B. DEFINITIONS:

THE COMPANY - Mondi Business Paper Hadera Ltd.

THE GROUP - the Company and its Subsidiaries, a list of which is presented in Note 7C.

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| | | |
|-------------------------|---|---|
| SUBSIDIARIES | - | companies in which the Company exercises over 50% ownership and control, directly or indirectly, and whose financial statements are fully consolidated with those of the Company. |
| RELATED PARTIES | - | as defined by Opinion No. 29 of the Institute of Certified Public Accountants in Israel. |
| INTERESTED PARTIES | - | as defined in the Israeli Securities Regulations (Presentation of Financial Statements), 1993. |
| CONTROLLING SHAREHOLDER | - | as defined in the Israeli Securities Regulations (Presentation of Transactions between a Corporation and its Controlling Shareholder in the Financial Statements), 1996. |
| NIS | - | New Israeli Shekel. |
| CPI | - | the Israeli consumer price index. |
| DOLLAR | - | the U.S. dollar. |
| EURO | - | the United European currency. |
| ADJUSTED AMOUNT | - | see Note 2A(1) below. |
| REPORTED AMOUNT | - | see Note 2A(1) below. |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF BUSINESS AND GENERAL (cont.)

C. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial

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statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The following are the principal accounting policies applied in the preparation of the financial statements in a manner consistent with previous years with the exception of the application of the provisions of Standard No. 19 "Income Taxex".

A. CESSATION OF FINANCIAL STATEMENT ADJUSTMENT AND CHANGE TO REPORTING IN REPORTED AMOUNTS - STANDARD NO. 12

(1) DEFINITIONS

ADJUSTED AMOUNT - historical nominal amount adjusted for changes in the exchange rate of the U.S. dollar as of December 31, 2003, in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel.

REPORTED AMOUNT - Adjusted Amount plus amounts in nominal terms added subsequent to December 31, 2003, and less amounts subtracted after that date.

(2) GENERAL

In January 2004, Israeli Accounting Standard No. 12 "Cessation of Financial Statements Adjustment" came into effect. Following the initial implementation of Standard No. 12, commencing January 1, 2004, the Group ceased the presentation of its financial statements based on nominal historical cost adjusted for the changes in the exchange rate of the U.S. dollar in relation to the NIS. Effective with the interim financial statements as of March 31, 2004 and for the reporting periods thereafter, including the years ended December 31, 2004 and 2005, the Group's financial statements are prepared and presented in Reported Amounts.

Comparative figures included in these financial statements relating to the year ended December 31, 2003, are presented in Adjusted Amounts.

The amounts at which non-monetary items are presented in these financial statements do not necessarily represent their realization value or economic value, but solely their Reported Amount.

The Company's condensed financial statements in nominal values, on the basis of which the Company's financial statements in Reported amounts and Adjusted Amounts were prepared, are presented in Note 24.

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NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

A. CESSATION OF FINANCIAL STATEMENT ADJUSTMENT AND CHANGE TO REPORTING IN REPORTED AMOUNTS - STANDARD NO. 12 (cont.)

(3) PRINCIPLES OF ADJUSTMENT APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIODS ENDED IN DECEMBER 31, 2005 AND 2004

a. BALANCE SHEET ITEMS

Non-monetary items (items whose balances reflect historical value at acquisition or upon establishment) are presented at their Adjusted Amounts as of December 31, 2003 plus additions and dispositions occurring subsequent to such date. Additions made subsequent to December 31, 2003 and dispositions of items added subsequent to such date, are presented at their historical nominal value. Dispositions of items added on or prior to December 31, 2003 are presented at their Adjusted Amount.

Monetary items (items whose balance sheet amount reflects their current value or realization value at the balance sheet date) are presented at their nominal value as of the balance sheet date.

Investments in Subsidiaries are presented based on the financial statements of these companies prepared according to the guidance of Standard No. 12.

b. STATEMENT OF OPERATIONS ITEMS

Income and expenses reflecting transactions, and financial income and expenses, are presented at their nominal value.

Income and expenses deriving from non-monetary items (mainly depreciation, amortization and changes in inventory) were presented in a manner corresponding to the presentation of the related non-monetary balance sheet item, as illustrated above.

The Company's share in the results of Subsidiaries is determined based on the financial statements of these companies prepared according to the guidance of Standard No. 12.

(4) PRINCIPLES OF ADJUSTMENT APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIOD ENDED THROUGH DECEMBER 31, 2003

STATEMENT OF OPERATIONS ITEMS

Income and expenses reflecting transactions, other

than financial income and expenses, were adjusted for changes in the exchange rate of the U.S. dollar from the date of the transaction through December 31, 2003.

Income and expenses deriving from non-monetary items (mainly depreciation, amortization, deferred taxes and changes in inventory) were presented in a manner corresponding to the adjustment of the related balance sheet items.

Financing expenses, net reflect income and expenses in real terms and include exchange rate differences derived from monetary items.

The Company's share in the results of Subsidiaries is determined based on the adjusted financial statements of these companies.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

B. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include consolidation of the financial statements of all Subsidiaries. Material inter-company balances and transactions of and between Subsidiaries have been fully eliminated.

The data included in the consolidated financial statements is based on audited financial statements of the Subsidiaries included therein.

For amortization policy of an unallocated goodwill associated with the acquisition of a Subsidiary, see H below.

C. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include bank deposits, available for immediate withdrawal, as well as unrestricted short-term deposits with maturities of less than three months from the date of deposit.

D. ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is computed on the specific identification basis for accounts whose collectibility, on management's estimation, is uncertain.

E. INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined for raw materials, auxiliary materials and finished products on the basis of weighted moving average cost per unit.

F. INVESTMENTS IN SUBSIDIARIES

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Investments in Subsidiaries are presented using the equity method based on their audited financial statements. For amortization the goodwill included in an investment in a Subsidiary, see H below.

G. FIXED ASSETS

Fixed assets are presented at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method at rates considered adequate to depreciate the assets over their estimated useful lives. Amortization of leasehold improvements is computed over the shorter of the term of the lease, including any option period, where the Company intends to exercise such option, or their useful life.

The annual depreciation and amortization rates are:

| | % |
|--------------------------------|------------------|
| | ----- |
| Leasehold improvements | 10 |
| Machinery and equipment | 5-20 (mainly 5%) |
| Motor vehicles | 15-20 |
| Office furniture and equipment | 7-33 |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

G. FIXED ASSETS (cont.)

IMPAIRMENT OF LONG-LIVED ASSETS

Management reviews long-lived assets on a periodic basis, as well as when such a review is required based upon relevant circumstances, to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. According to the Israeli Accounting Standards Board's Standard No. 15, "Impairment of Assets", an asset's recoverable value is the higher of the asset's net selling price and the asset's value in use, the latter being equal to the asset's discounted expected cash flows. If applicable, an impairment charge is recorded at the amount in which the carrying amount of the asset exceeds its recoverable value.

H. OTHER ASSETS - GOODWILL

The unallocated excess cost of an investment in a Subsidiary over its net book value at the acquisition date reflects goodwill. The goodwill is amortized over the expected estimated economic life of the goodwill (10 years) using a straight-line method. The amortization period and method were determined following the provisions of Standard No. 20 "The amortization Period of Goodwill" which calls for the amortization of goodwill over its useful life, based on a systematic method that should reflect the estimated expected

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period in which the goodwill is to contribute economic benefits. Impairment examinations and recognition are performed and determined based on the accounting policy outlined in G above.

I. DEFERRED INCOME TAXES

The Group records deferred income taxes in respect of temporary differences between the carrying values of assets and liabilities in the financial statements and their values for tax purposes, including depreciation differences on leased property and fixed assets. The Group records deferred-tax assets in respect of temporary differences as well as in respect of carry-forward tax losses so long as it is probable that those assets will be realized. The deferred income taxes are computed by the tax rates expected to be in effect at realization, as they are known at the balance sheet date.

The computation of deferred income taxes has not taken into account taxes that would have been applicable in case of future realization of investments in Subsidiaries, since the Group does not contemplate such realization in the foreseeable future.

J. REVENUE RECOGNITION

Revenues are recognized upon shipment, when title has been transferred and collectibility is reasonably assured. Revenues are presented net of discounts granted. The accrual for estimated discounts granted is computed according to the provisions stipulated in the agreements, and is recorded when revenues are recognized.

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MONDI BUSINESS PAPER HADERA LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

K. SUPPLIER DISCOUNTS

Ongoing discounts granted by suppliers, as well as year end discounts, in respect of which no commitments to meet given targets are required by the Group, are included in the financial statements upon the execution of purchases that grant the Group said discounts. Supplier discounts contingent upon the Group's fulfillment of certain targets, such as meeting a minimal annual volume (in quantities or amount), or an increase in purchases over previous periods, are included in the financial statements in proportion to Group's purchases from suppliers during the reported period, which advance the Group towards the stated targets, only if it is expected that those targets will be reached and the discounts can reasonably be estimated. Management's estimate of meeting the targets is based, inter-alia, on historical experience, Group's relationships established with the suppliers and the estimated volume of purchases during the remaining reported period.

L. FORWARD TRANSACTIONS

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The gain or loss of currency forward transactions designated to hedge long-term loans from banks against currency fluctuations, are included in operations as incurred.

M. EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is computed based on the weighted average number of paid up capital shares during the year.

N. EXCHANGE RATES AND LINKAGE BASIS

(1) Balances in foreign currency or linked thereto are included in the financial statements based on the representative exchange rates, as published by the Bank of Israel, that were prevailing at the balance sheet date.

(2) Following are the changes in the representative exchange rate of the U.S. dollar vis-a-vis the NIS and in the Israeli CPI:

| AS OF: | REPRESENTATIVE EXCHANGE RATE OF THE DOLLAR (NIS PER \$1) ----- | CPI "IN RESPECT OF" (IN POINTS) ----- |
|------------------------|--|--|
| December 31, 2005 | 4.603 | 185.80 |
| December 31, 2004 | 4.308 | 180.74 |
| December 31, 2003 | 4.379 | 178.58 |
| INCREASE (DECREASE) | | |
| DURING THE YEAR ENDED: | % | % |
| | - | - |
| December 31, 2005 | 6.8 | 2.8 |
| December 31, 2004 | (1.6) | 1.2 |
| December 31, 2003 | (7.6) | (1.9) |

(3) Exchange-rate differences are charged to operations as incurred.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

O. RECENT ACCOUNTING STANDARDS

(1) ACCOUNTING STANDARD NO. 21 "EARNINGS PER SHARE"

In February 2006, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 21, "Earnings Per Share" (the "Standard"). With the initial adoption of the Standard, Opinion No. 55

of the Institute of Certified Public Accountants in Israel - Earnings per share will be cancelled. The Standard prescribes that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the entity and, if presented, profit or loss from continuing operations attributable to those equity holders. The basic earnings per share shall be calculated by dividing profit or loss attributable to ordinary equity holders of the entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the reported period.

For the purpose of calculating diluted earnings per share, an entity shall adjust profit or loss attributable to ordinary equity holders of the entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.

The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter. The initial adoption of the Standard will be accounted for retrospectively and comparative Earnings per share data for prior periods shall be adjusted. The application of the Standard is not expected to materially affect the Company's Earnings per share data.

(2) ACCOUNTING STANDARD NO. 22
"FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION"

In July 2005, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 22, "Financial Instruments: Disclosure and Presentation". Financial instrument under this Standard is, in general, any contract that establishes a financial asset of an entity, or a financial liability or equity instrument of another entity.

This Standard establishes the requirements for presentation of financial instruments in the financial statements and indicates the information that should be disclosed in relation thereto. The presentation requirements relate to the classification of financial instruments as financial assets, financial liabilities or equity instruments. It also deals with the classification of related interest, dividends, losses and gains and to the circumstances under which financial assets and liabilities derived from financial instruments are to be offset. The Standard requires disclosure of information relating to factors affecting the amount, timing and certainty of the entity's future cash flows relating to financial instruments and accounting policy implemented in respect of these instruments. The Standard also establishes requirements for disclosure of information about the nature and the extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them and management's policies

for the oversight of those risks.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

O. RECENT ACCOUNTING STANDARDS (cont.)

- (2) ACCOUNTING STANDARD NO. 22
"FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION"
(cont.)

Standard No. 22 is effective for financial statements for periods commencing January 1, 2006 or thereafter. The initial adoption of the Standard will be accounted for prospectively. Comparative financial statements for prior periods shall not be adjusted. The Standard's effect on the Group's financial statements is not expected to be significant.

- (3) ACCOUNTING STANDARD NO. 24 "SHARE-BASED PAYMENT"

In September 2005, the Israeli Accounting Standards Board published Accounting Standard No. 24 "Share-Based Payment" (the "Standard"), which calls for the recognition in the financial statements of share-based payment transactions. Such transactions include transactions with employees and related parties to be settled by cash, by other assets, or by equity instruments. Consequently, amongst other matters, costs associated with grants of shares and options to employees will be expensed over the vesting period of each grant. These costs will be determined based on the fair value of the awards at each grant date. The Standard establishes guidelines for measuring each award based on the settlement terms (either by cash or equity instrument). The Standard also establishes certain disclosure requirements relating to share-based payment.

The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter (initial adoption is recommended). The application of the Standard is not expected to affect the Company's financial position and results of operations.

- (4) ACCOUNTING STANDARD NO. 25 "REVENUES"

In February 2006, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 25, "Revenues" (the "Standard").

This Standard establishes the requirements for recognition criteria, measurement, disclosure and presentation of revenues arising from sale of goods, rendering of services and from the use by others of entity assets yielding interest, royalties and dividends. This Standard prescribes that revenue shall be measured at the fair value of the

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consideration received or receivable. The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter. Assets and liabilities included in the financial statements as of December 31, 2005 in different amounts from those that would have been presented if the standard's requirements were applied will be adjusted on January 1, 2006 to the amounts to be recognized in accordance with the Standard's guidelines. The results of the initial adoption of the Standard as at January 1, 2006 shall be accounted for by the cumulative effect of a change in accounting method.

The company is currently evaluating the impact, if any, of the adoption of the Standard on its financial position and results of operations.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 3 - CASH AND CASH EQUIVALENTS

| | CONSOLIDATED | | |
|---|------------------|---------|--------------|
| | | | DECEMBER 31, |
| | 2 0 0 5 | 2 0 0 4 | 2 0 |
| | REPORTED AMOUNTS | | |
| | NIS IN THOUSANDS | | |
| In NIS | - | 10,215 | |
| In foreign currencies (primarily in U.S. dollar) | - | 589 | |
| | - | 10,804 | |

NOTE 4 - TRADE RECEIVABLES

| | CONSOLIDATED | | |
|--------------|------------------|---------|--------------|
| | | | DECEMBER 31, |
| | 2 0 0 5 | 2 0 0 4 | |
| | REPORTED AMOUNTS | | |
| | NIS IN THOUSANDS | | |
| COMPOSITION: | | | |

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| | | |
|--|---------|---------|
| Domestic | | |
| Open accounts | 117,150 | 107,693 |
| Checks receivable | 29,538 | 29,943 |
| | ----- | ----- |
| | 146,688 | 137,636 |
| | ----- | ----- |
| Foreign | | |
| Open accounts (primarily in u.s. dollar) | 4,311 | 749 |
| Related parties | 12,135 | 21,872 |
| | ----- | ----- |
| | 16,446 | 22,621 |
| | ----- | ----- |
| | 163,134 | 160,257 |
| Less - allowance for doubtful accounts | 2,259 | 2,442 |
| | ----- | ----- |
| | 160,875 | 157,815 |
| | ----- | ----- |

NOTE 5 - OTHER RECEIVABLES

| | CONSOLIDATED | | COMPANY |
|---------------------------|------------------|---------|------------------|
| | DECEMBER 31, | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 5 |
| | REPORTED AMOUNTS | | REPORTED AMOUNTS |
| COMPOSITION: | NIS IN THOUSANDS | | NIS IN THOUSANDS |
| Deferred taxes (Note 21D) | 6,899 | 3,952 | 5,876 |
| Prepaid expenses | 527 | 842 | 2,161 |
| Advances to suppliers | 2,642 | 1,133 | 2,640 |
| Value Added Tax | - | - | 4,065 |
| Income tax advances, net | 207 | 240 | - |
| Others | 597 | 1,413 | 71 |
| | ----- | ----- | ----- |
| | 10,872 | 7,580 | 14,813 |
| | ----- | ----- | ----- |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 6 - INVENTORIES

| | CONSOLIDATED |
|--|--------------|
| | DECEMBER 31, |
| | 2 0 0 5 |
| | 2 0 0 4 |
| | ----- |
| | ----- |

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| | ----- | ----- |
|--|------------------|-----------|
| | REPORTED AMOUNTS | |
| | ----- | |
| | NIS IN THOUSANDS | |
| | ----- | ----- |
| Raw and auxiliary materials | 38,134 | 30,098 |
| Finished products and goods in process (1) | 78,725 | 60,293 |
| | ----- | ----- |
| | 116,859 | 90,391 |
| | ----- | ----- |
| (1) Includes products in transit | 857 | (*) 3,812 |
| | ----- | ----- |
| The inventories are presented net of provision for obsolescence | 715 | 1,302 |
| | ----- | ----- |

(*) Reclassified

NOTE 7 - INVESTMENTS IN SUBSIDIARIES

A. COMPOSITION

Cost of shares
Accumulated losses since acquisition, net

B. GOODWILL:

Cost
Less - accumulated amortization

C. CONSOLIDATED SUBSIDIARIES

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The consolidated financial statements as of December 31, 2005, include the financial statements of the following Subsidiaries:

Mondi Business Paper Hadera Marketing Ltd.
 Grafinir Paper Marketing Ltd.
 Yavnir (1999) Ltd.
 Miterani Paper Marketing 2000 (1998) Ltd.

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MONDI BUSINESS PAPER HADERA LTD.
 NOTES TO FINANCIAL STATEMENTS

NOTE 8 - FIXED ASSETS

| | LEASEHOLD IMPROVEMENTS | MACHINERY AND EQUIPMENT | MOTOR VEHICLES | OFFICE FURNITURE COMPUTERS AND EQUIPMENT |
|-----------------------------|---------------------------|-------------------------------|-------------------|--|
| | REPORTED AMOUNTS | | | |
| | NIS IN THOUSANDS | | | |
| CONSOLIDATED | | | | |
| ----- | | | | |
| COST: | | | | |
| Balance - January 1, 2005 | 3,724 | 140,228 | 2,285 | 2 |
| Changes during 2005: | | | | |
| Additions | - | 53,275 | 348 | |
| Dispositions | - | (370) | (151) | |
| | ----- | ----- | ----- | ----- |
| Balance - December 31, 2005 | 3,724 | 193,133 | 2,482 | 3 |
| | ----- | ----- | ----- | ----- |
| ACCUMULATED DEPRECIATION: | | | | |
| Balance - January 1, 2005 | 1,816 | 28,755 | 1,328 | 1 |
| Changes during 2005: | | | | |
| Additions | 388 | 8,904 | 380 | |
| Dispositions | - | (187) | (151) | |
| | ----- | ----- | ----- | ----- |
| Balance - December 31, 2005 | 2,204 | 37,472 | 1,557 | 1 |
| | ----- | ----- | ----- | ----- |
| NET BOOK VALUE: | | | | |
| December 31, 2005 | 1,520 | 155,661 | 925 | 1 |
| | ----- | ----- | ----- | ----- |

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| | | | | |
|-----------------------------|-------|---------|-------|---|
| December 31, 2004 | 1,908 | 111,473 | 957 | 1 |
| | ----- | ----- | ----- | |
| COMPANY | | | | |
| ----- | | | | |
| COST: | | | | |
| Balance - January 1, 2005 | 2,651 | 138,904 | 875 | 1 |
| Changes during 2005: | | | | |
| Additions | - | 53,275 | 348 | |
| Dispositions | - | (339) | - | |
| | ----- | ----- | ----- | |
| Balance - December 31, 2005 | 2,651 | 191,840 | 1,223 | 2 |
| | ----- | ----- | ----- | |
| ACCUMULATED DEPRECIATION: | | | | |
| Balance - January 1, 2005 | 1,305 | 27,928 | 158 | |
| Changes during 2005: | | | | |
| Additions | 265 | 8,787 | 215 | |
| Dispositions | - | (157) | - | |
| | ----- | ----- | ----- | |
| Balance - December 31, 2005 | 1,570 | 36,558 | 373 | 1 |
| | ----- | ----- | ----- | |
| NET BOOK VALUE: | | | | |
| December 31, 2005 | 1,081 | 155,282 | 850 | |
| | ----- | ----- | ----- | |
| December 31, 2004 | 1,346 | 110,976 | 717 | |
| | ----- | ----- | ----- | |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 9 - TRADE PAYABLES

| | CONSOLIDATED | |
|---|------------------|---------|
| | DECEMBER | |
| | 2 0 0 5 | 2 0 0 4 |
| | ----- | ----- |
| | REPORTED AMOUNTS | |
| | ----- | |
| | NIS IN THOUSANDS | |
| | ----- | |
| In Israeli currency | 27,539 | 22,484 |
| In foreign currency or linked thereto (primarily in u.s. dollar) | 75,445 | 82,177 |
| | ----- | ----- |
| | 102,984 | 104,661 |
| | ----- | ----- |

NOTE 10 - OTHER PAYABLES AND ACCRUED EXPENSES

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| | CONSOLIDATED | |
|--|------------------|---------|
| | DECEMBER | |
| | 2 0 0 5 | 2 0 0 4 |
| | REPORTED AMOUNTS | |
| | NIS IN THOUSANDS | |
| Accrued payroll and related expenses | 13,772 | 11,703 |
| Value Added Tax | 1,030 | 3,366 |
| Advances from customers | 448 | 862 |
| NAG - Parent Company (in u.s. dollar) | 3,241 | 2,252 |
| Interest payable | 1,049 | 2,900 |
| Forward transaction | - | 1,322 |
| Other | 662 | 727 |
| | 20,202 | 23,132 |

NOTE 11 - LONG-TERM BANK LOANS

INTEREST
RATE

% (*)

A.COMPOSITION

| | |
|---------------------------|------|
| In U.S. dollar (**) | 5.67 |
| In NIS indexed to the CPI | 6.55 |

Less - current maturities

(*) Annual average interest rate as of December 31, 2005.

(**) As of December 31, 2005, NIS 17,078 thousand bear interest based on Libor plus + 0.5%-0.6%.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 11 -LONG-TERM BANK LOANS (cont.)

B. MATURITIES NIS IN THOUSANDS

Second year - 2007
Third year - 2008
Fourth year - 2009
Fifth year (2010) and thereafter

- C. According to the loan agreements with the banks, as amended in the second half of 2005, the Company is to achieve, inter alia, financial ratio at the end of each audited fiscal year of total shareholders equity (which includes capital notes to shareholders) to total assets to be no less than 23% (prior to the amendment, the required ratio under the covenant was 30%). In case the Company fails to fulfill these covenants, the banks are entitled to demand early repayment of the loans, in whole or in part. As of December 31, 2005, the Company was in full compliance with the covenants stipulated in the bank agreements and this financial ratio amounted to 25.11%.
- D. As to a "negative pledge agreement" signed by the Company, see Note 14B.
- E. In 2004 and 2003, the Company and its Subsidiaries entered into an agreement for a bank credit facility, pursuant to which the Company and its Subsidiaries may, from time to time, borrow an aggregate principal amount of up to adjusted NIS 122,000 thousand. Under the terms of the agreement, the credit facility has no time limit. As of the balance sheet date, the Group utilized NIS 85,887 thousand of the credit facility.

NOTE 12 -CAPITAL NOTES TO SHAREHOLDERS

The capital notes to shareholders are linked to the dollar and bear no interest. According to the terms of the capital notes, the Company has the ultimate discretion upon the dates of repayment of the capital notes. As of December 31, 2005, management intends to repay the capital note at their entirety by the end of 2006.

NOTE 13 -ACCRUED SEVERANCE PAY, NET

Israeli law and labor agreements determine the obligations of the Group to make severance payments to dismissed employees and to

employees leaving employment under certain other circumstances. The liability for severance pay benefits, as determined by Israeli Law, is based upon length of service and the employee's most recent monthly salary. The liability of the Group for severance pay to its permanent employees is covered by current deposits to pension and severance funds. Accumulated amounts so funded are not under the control or administration of the Group, and accordingly, neither those amounts nor the corresponding accruals are reflected in the financial statements. The amounts presented in the balance sheet as of December 31, 2005 reflects the severance pay liability in respect of temporary employees.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 14 -COMMITMENTS AND CONTINGENT LIABILITIES

A. COMMITMENTS:

- (1) The Group is obligated to pay license fees to a shareholder - see Note 22B.
- (2) The Company and its Subsidiaries lease certain of their facilities under operating leases for varying periods with renewal options primarily from AIPM. Future minimum lease rentals as of December 31, 2005 are as follows:

| | CONSOLIDATED REPORTED AMO NIS IN THOUS |
|------|--|
| 2006 | 4,914 |
| 2007 | 4,914 |
| 2008 | 4,757 |
| 2009 | 3,682 |
| | 18,267 |

B. Liens

To secure long-term bank loans and short-term bank credits (the balance of which as of December, 31 2005 is NIS 38,049 thousand), the Company entered into a "negative pledge" agreement under which the Company is committed not to pledge any of its assets, excluding fixed pledges relating to assets financed by others, prior to the consent of the banks.

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C. Guarantees

The Company from time to time and in the framework of its ongoing operations provides guarantees, the amount of which as of December, 31 2005 was NIS 8,268 thousand.

NOTE 15 - SHARE CAPITAL

A. As of December 31, 2005 and 2004, share capital is composed of ordinary shares of NIS 1.00 par value each. Authorized - 38,000 shares; issued and paid up - 1,000 shares.

B. Holders of ordinary shares are entitled to participate equally in the payment of cash dividends and bonus share (stock dividend) distributions and, in the event of the liquidation of the Company, in the distribution of assets after satisfaction of liabilities to creditors. See also Note 1A.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 16 - NET SALES

| | CONSOLIDATED | | | YE | |
|-----------------------|-------------------------|------------------|------------------|---------|------------------|
| | YEAR ENDED DECEMBER 31, | | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | | |
| Industrial operations | 460,383 | 471,190 | 453,807 | 462,177 | |
| Commercial operations | 202,955 | 214,904 | 186,213 | - | |
| | 663,338 | 686,094 | 640,020 | 462,177 | |

NOTE 17 - COST OF SALES

| | CONSOLIDATED | | | YE | |
|--|-------------------------|------------------|------------------|----|------------------|
| | YEAR ENDED DECEMBER 31, | | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | | REPORTED AMOUNTS |

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| | NIS IN THOUSANDS | | | |
|---|------------------|---------|---------|----------|
| Purchases (*) | 187,618 | 188,013 | 177,176 | - |
| Materials consumed | 306,803 | 297,006 | 271,334 | 306,803 |
| Salaries and related expenses | 36,391 | 32,576 | 30,482 | 36,391 |
| Subcontracting | 5,898 | 5,066 | 4,388 | 5,898 |
| Energy costs | 54,883 | 45,991 | 43,166 | 54,883 |
| Depreciation | 9,607 | 7,896 | 7,243 | 9,607 |
| Other manufacturing costs and expenses (including rent) | 29,939 | 31,124 | 30,370 | 29,093 |
| | 631,139 | 607,672 | 564,159 | 442,675 |
| Change in finished goods , goods in process, and products in transit.(**) | (21,387) | (1,934) | (7,269) | (22,117) |
| | 609,752 | 605,738 | 556,890 | 420,558 |

(*) The purchases of the Group are related principally to commercial operations.

(**) CHANGE IN RAW AND AUXILIARY MATERIALS ARE INCLUDED IN MATERIALS CONSUMED.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 18 - SELLING EXPENSES

| | CONSOLIDATED | | | |
|--|-------------------------|---------------------|---------------------|---------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| Salaries and related expenses | 17,205 | 17,169 | 16,913 | 17,146 |
| Packaging and shipping to customers | 16,719 | 16,235 | 14,368 | 16,096 |
| Maintenance and rent | 8,237 | 7,973 | 7,641 | 750 |
| Transportation expenses | 1,360 | 1,256 | 1,178 | 1,349 |
| Advertising | 166 | - | 180 | 166 |
| Commissions and license fees to a shareholder | 1,164 | 2,912 | 1,865 | - |
| Depreciation | 417 | 552 | 670 | 417 |
| Other | - | 38 | 77 | - |
| | 45,268 | 46,135 | 42,892 | 35,924 |

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NOTE 19 - GENERAL AND ADMINISTRATIVE EXPENSES

| | CONSOLIDATED | | | YE 2 0 0 5 |
|-------------------------------------|-------------------------|---------------------|---------------------|---------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | |
| | NIS IN THOUSANDS | | | |
| Salaries and related expenses | 3,863 | 3,811 | 3,821 | 3,863 |
| Office maintenance | 169 | 187 | 232 | - |
| Professional and management fees | 2,060 | 2,217 | 1,594 | 1,537 |
| Depreciation | 74 | 47 | 28 | 74 |
| Amortization of goodwill | 623 | 623 | 623 | - |
| Bad and doubtful debts | (840) | (311) | 679 | - |
| Other | 1,352 | 1,229 | 1,448 | 1,228 |
| | 7,301 | 7,803 | 8,425 | 6,702 |

NOTE 20 - FINANCING INCOME (EXPENSES), NET

| | CONSOLIDATED | | | YE 2 0 0 5 |
|--|-------------------------|---------------------|---------------------|---------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | |
| | NIS IN THOUSANDS | | | |
| Interest on long-term bank loans | 2,486 | 2,573 | 3,254 | 4,935 |
| Erosion of monetary assets and liabilities, net | 5,630 | 2,070 | (783) | 4,883 |
| Forward transaction | (1,497) | 1,322 | - | (1,497) |

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NOTES TO FINANCIAL STATEMENTS

NOTE 21 - INCOME TAXES (TAXES BENEFITS)

A. The Company and its Subsidiaries are taxed according to the provisions of The Income Tax Ordinance and the Income Tax Law (Inflationary Adjustments), 1985. The Company is an industrial company in conformity with the Law for the Encouragement of Industry (Taxes), 1969. The major benefits the Company is entitled to under this law is accelerated depreciation rates.

| | CONSOLIDATED | | | YEAR ENDED DECEMBER 31, |
|---------------------------------|-------------------------|---------------------|---------------------|-------------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR ENDED DECEMBER 31, |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| | | | | |
| B. COMPOSITION | | | | |
| Current taxes | 54 | 81 | 80 | - |
| Taxes in respect of prior years | 36 | (86) | - | - |
| Deferred taxes (E. below) | (8,470) | 823 | 10,438 | (8,470) |
| | (8,380) | 818 | 10,518 | (8,470) |

C. RECONCILIATION OF THE STATUTORY TAX RATE TO THE EFFECTIVE TAX RATE

| | CONSOLIDATED | | | YEAR ENDED DECEMBER 31, |
|------------------------------------|-------------------------|---------------------|---------------------|-------------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR ENDED DECEMBER 31, |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| | | | | |
| Income (loss) before income taxes | (11,786) | 18,080 | 29,037 | (12,540) |
| Statutory tax rate | 34% | 35% | 36% | 34% |
| Tax computed by statutory tax rate | (4,007) | 6,328 | 10,453 | (4,264) |
| TAX INCREMENTS (SAVINGS) | | | | |

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| | | | | |
|--|---------|---------|--------|---------|
| DUE TO: | | | | |
| Non-deductible expenses | 212 | 211 | 226 | - |
| Non-taxable income | (22) | (40) | - | - |
| Reduction in corporate tax rates - (E. below) | (3,888) | (4,397) | - | (3,962) |
| Differences arising from | | | | |
| basis of measurement (*) | (711) | (1,198) | (161) | (244) |
| Prior years income taxes | 36 | (86) | - | - |
| | ----- | ----- | ----- | ----- |
| | (8,380) | 818 | 10,518 | (8,470) |
| | ----- | ----- | ----- | ----- |

(*) For 2004 and 2005 - Reported Amounts (NIS) for financial reporting purposes vis-a-vis the consumer price index for tax purposes;

For 2003 - U.S. dollar for financial reporting purposes vis-a-vis the Consumer Price Index for tax purposes.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 21 - INCOME TAXES (TAXES BENEFITS) (cont.)

D. DEFERRED TAXES

| | CONSOLIDATED | | | |
|---------------------------------|-------------------------|----------|----------|----------|
| | YEAR ENDED DECEMBER 31, | | | YEAR |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | ----- | ----- | ----- | ----- |
| | REPORTED | REPORTED | ADJUSTED | REPORTED |
| | AMOUNTS | AMOUNTS | AMOUNTS | AMOUNTS |
| | ----- | ----- | ----- | ----- |
| | NIS IN THOUSANDS | | | |
| | ----- | ----- | ----- | ----- |
| Balance as of beginning of year | (21,470) | (20,647) | (10,209) | (22,494) |
| Changes during the year | 4,582 | (5,220) | (10,438) | 4,508 |
| Adjustment due to | | | | |
| change in income tax rates | 3,888 | 4,397 | - | 3,962 |
| | ----- | ----- | ----- | ----- |
| Balance as of end of year | (13,001) | (21,470) | (20,647) | (14,024) |
| | ----- | ----- | ----- | ----- |

CONSOLIDATED

DEC

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| 2 0 0 5 | 2 0 0 4 |
|---------------------|---------------------|
| REPORTED AMOUNTS | REPORTED AMOUNTS |
| NIS IN THOUSANDS | |

DEFERRED TAXES ARE PRESENTED IN THE
BALANCE SHEETS AS FOLLOWS:

Other receivables and prepayments (Note 5):

| | | |
|---------------------------------|-------|-------|
| Allowance for doubtful accounts | 700 | 831 |
| Vacation and recreation pay | 1,589 | 1,564 |
| Carry forward tax losses | 4,609 | 1,557 |
| | 6,899 | 3,952 |

Long-term liabilities:

| | | |
|--------------------------------|----------|----------|
| Depreciable fixed assets | (23,596) | (25,448) |
| Accrued severance pay, net | 13 | 26 |
| Less- Carry forward tax losses | 3,683 | - |
| | (19,900) | (25,422) |
| | (13,001) | (21,470) |

For 2005 - Deferred taxes were computed at rates between 31%-25%,
primarily - 25%.

For 2004 - Deferred taxes were computed at rates between 30%-34%,
primarily - 30%.

For 2003 - Deferred taxes were computed at 36%.

Deferred taxes are recognized in respect of all carry forward losses of
the Group, see F.

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 21 - INCOME TAXES (TAXES BENEFITS) (cont.)

E. REDUCTION OF CORPORATE TAX RATES

In July 2005, the Israeli Knesset passed the Law for Amending the
Income Tax Ordinance (No. 147), 2005, according to which commencing in
2006 the corporate income-tax rate would be gradually reduced, for
which a 31% tax rate was established, through 2010, in respect of which
a 25% tax rate was established. The effect of this amendment on the
Group's deferred income tax provisions is reflected by an increase of
NIS 3,888 thousand in income tax benefit for the year ended December
31, 2005.

F. Carryforward tax losses of the Group and the Company are NIS 26,814
thousand and NIS 27,250 thousand as of December 31, 2005, respectively.

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G. The Company and its Subsidiaries have tax assessments that are considered final through the 2000 tax year.

NOTE 22 - RELATED PARTIES AND INTERESTED PARTIES

A. Balances with Related Parties and Subsidiaries

| | CONSOLIDATED | |
|---|------------------|------------------|
| | 2005 | 2004 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | |
| Trade receivables - AIPM | - | - |
| Trade receivables - related parties | 12,135 | 21,872 |
| Trade payables - AIPM | 69,854 | 65,033 |
| Trade payables - related parties | 4,032 | 9,009 |
| Other payables and accrued expenses - AIPM | 2,406 | 2,478 |
| Other payables and accrued expenses - related parties | 3,241 | 2,252 |
| Capital notes to shareholders | 18,412 | 17,233 |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 22 - RELATED PARTIES AND INTERESTED PARTIES (cont.)

B. TRANSACTIONS WITH RELATED PARTIES AND SUBSIDIARIES

| | CONSOLIDATED | | | 2005 |
|--|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2005 | 2004 | 2003 | REPORTED AMOUNTS |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |

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| | | | | |
|--|---------|---------|---------|---------|
| Sales to related parties | 103,196 | 165,596 | 171,131 | - |
| | ----- | ----- | ----- | ----- |
| Sales to Subsidiaries | - | - | - | 462,177 |
| | ----- | ----- | ----- | ----- |
| Cost of sales | 106,076 | 106,546 | 88,613 | 77,930 |
| | ----- | ----- | ----- | ----- |
| Selling expenses, net (Participation in selling expenses, net) | 5,969 | 9,875 | 6,428 | (450) |
| | ----- | ----- | ----- | ----- |
| General and administrative expenses | 1,750 | 1,837 | 1,410 | 1,447 |
| | ----- | ----- | ----- | ----- |
| Financing expenses (income), net | 2,406 | 1,939 | 13,759 | 1,845 |
| | ----- | ----- | ----- | ----- |

- C. (1) The Company leases its premises from AIPM and render services (including electricity, water, maintenance and professional services) under agreements, which are renewed every year.
- (2) The Group is obligated to pay commissions and license fees to NAG.

NOTE 23 - DISCLOSURE AND PRESENTATION OF FINANCIAL INSTRUMENTS

A. CREDIT RISK

The revenues of the Group's are derive from a large number of customers mainly in Israel and in Europe. Management regularly monitors the balance of trade receivables and the financial statements include an allowance for doubtful accounts based on management's estimation. Taking the aforementioned into consideration, the exposure to credit risk from trade receivables is immaterial.

Cash and cash equivalents (including amounts in foreign currency) are deposited with major commercial banks in Israel.

B. FAIR VALUE OF FINANCIAL INSTRUMENTS

The financial instruments of the Group consist primarily of non-derivative assets and liabilities. Non-derivative assets include cash and cash equivalents, receivables, other current assets and long-term loans given. Non-derivative liabilities include short-term bank credit, trade payables, other current liabilities, long-term loans from banks and capital notes to shareholders. Due to the nature of these financial instruments, their fair value, generally, is identical or close to the value at which they are presented in the financial statements, unless stated otherwise.

The fair value of the long-term loans approximates their carrying value, since they bear interest at rates close to the prevailing market rates.

The Group enters from time to time into off-balance sheet financial instruments for hedging against currency and interest-rate risks.

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NOTE 24 - COMPANY'S FINANCIAL STATEMENTS IN NOMINAL VALUES
FOR TAX PURPOSES

A. BALANCE SHEETS

| | COMPAN |
|--|---|
| | ----- DECEMBER ----- |
| | 2 0 0 5 ----- NIS IN THO ----- |
| CURRENT ASSETS | |
| Cash and cash equivalents | - |
| American Israeli Paper Mills Group, net | 231,715 |
| Other receivables | 14,869 |
| Inventories | 90,454 |
| | ----- |
| | 337,038 |
| | ----- |
| LONG-TERM INVESTMENTS | |
| Investments in Subsidiaries | 1,312 |
| | ----- |
| FIXED ASSETS, NET | 155,315 |
| | ----- |
| LONG -TERM ASSETS | |
| Deferred Taxes | 2,555 |
| | ----- |
| | 496,220 |
| | ----- |
| CURRENT LIABILITIES | |
| Short term bank credit | 85,871 |
| Current maturities of long-term bank loans | 16,242 |
| Capital notes to shareholders | 18,412 |
| Trade payables | 75,367 |
| Subsidiaries | 148,844 |
| Other payables and accrued expenses | 15,386 |
| | ----- |
| | 360,122 |
| | ----- |
| LONG TERM LIABILITIES | |
| Long-term bank loans | 21,807 |
| Capital notes to shareholders | - |
| Accrued severance pay, net | 51 |
| | ----- |
| | 21,858 |
| | ----- |
| SHAREHOLDERS' EQUITY | 114,240 |
| | ----- |
| | 496,220 |
| | ----- |

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MONDI BUSINESS PAPER HADERA LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 24 - COMPANY'S FINANCIAL STATEMENTS IN NOMINAL VALUES
FOR TAX PURPOSES (cont.)

B. STATEMENT OF OPERATIONS

| | YEAR ENDED | |
|---|------------------|---------|
| | 2 0 0 5 | 2 0 0 4 |
| | NIS IN THOUSANDS | |
| Net sales | 462,177 | 482,177 |
| Cost of sales | 420,394 | 417,394 |
| GROSS PROFIT | 41,783 | 64,783 |
| Selling expenses | 35,904 | 34,904 |
| General and administrative expenses | 6,698 | 6,698 |
| OPERATING PROFIT (LOSS) | (819) | 23,783 |
| Financing (expenses) income, net | (11,533) | (7,533) |
| Other income (expenses), net | - | - |
| INCOME (LOSS) BEFORE INCOME TAX BENEFITS | (12,352) | 16,250 |
| Income tax benefits | 8,470 | 8,470 |
| INCOME (LOSS) AFTER INCOME TAX BENEFITS | (3,882) | 24,720 |
| Equity in net earnings (losses) of Subsidiaries | 664 | 664 |
| NET INCOME (LOSS) FOR THE YEAR | (3,218) | 25,384 |

C. STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | SHARE CAPITAL | PREMIUM | RETAINED EARNING |
|---------------------------|------------------|---------|---------------------|
| | NIS IN THOUSANDS | | |
| BALANCE - JANUARY 1, 2003 | 1 | 41,125 | 25,006 |
| CHANGES DURING 2003: | | | |

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| | | | |
|-----------------------------|---|--------|---------|
| Net income for the year | - | - | 34,324 |
| | - | ----- | ----- |
| BALANCE - DECEMBER 31, 2003 | 1 | 41,125 | 59,330 |
| CHANGES DURING 2004: | | | |
| Net income for the year | - | - | 17,002 |
| | - | ----- | ----- |
| BALANCE - DECEMBER 31, 2004 | 1 | 41,125 | 76,332 |
| CHANGES DURING 2005: | | | |
| Loss for the year | - | - | (3,218) |
| | - | ----- | ----- |
| BALANCE - DECEMBER 31, 2005 | 1 | 41,125 | 73,114 |
| | - | ----- | ----- |

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EXHIBIT 5

HOGLA-KIMBERLY LTD.
FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005

HOGLA-KIMBERLY LTD.
FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005

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Statements of Changes in Shareholders' Equity

Statements of Cash Flows

Notes to the Financial Statements

1 Azrieli Center
Tel Aviv 67021
P.O.B. 16593, Tel Aviv 61164
Israel

Tel: +972 (3) 608 5555
Fax: +972 (3) 609 4022
info@deloitte.co.il
www.deloitte.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE SHAREHOLDERS OF

HOGLA-KIMBERLY LTD.

We have audited the accompanying balance sheets of HOGLA-KIMBERLY LTD. ("the Company") as of December 31, 2005 and 2004, and the consolidated balance sheets as of such dates, and the related statements of operations, changes in shareholders' equity and cash flows - of the Company and on a consolidated basis - 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 conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States) and with generally accepted auditing standards in Israel, including those prescribed by the Israeli Auditors' Regulations (Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position - of the Company and on a consolidated basis - as of December 31, 2005 and 2004, and the results of operations, changes in shareholders' equity and cash flows - of the Company and on a consolidated basis - for each of the three years in the period ended December 31, 2005, in accordance with generally accepted accounting principles in Israel. In addition, in our opinion, the financial statements referred to above are prepared in accordance with the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

BRIGHTMAN ALMAGOR & CO.
CERTIFIED PUBLIC ACCOUNTANTS

A MEMBER FIRM OF DELOITTE TOUCHE TOHMATSU

Tel Aviv, Israel:
March 2, 2006

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HOGLA-KIMBERLY LTD.
BALANCE SHEETS
(NIS in thousands)

| | NOTE | CONSOLIDATED | |
|---------------------------------|------|--------------|-------------|
| | | DECEMBER 31, | |
| | | 2 0 0 5 | 2 0 0 4 |
| | | REPORTED | REPORTED |
| | | AMOUNTS (1) | AMOUNTS (1) |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | 3 | 35,551 | 117,364 |
| Trade receivables | 4 | 257,899 | 214,389 |
| Other receivables | 5 | 59,805 | 35,725 |
| Inventories | 6 | 148,077 | 142,551 |
| | | 501,332 | 510,029 |
| LONG-TERM INVESTMENTS | | | |
| Long-term bank deposit | 7 | - | 68,928 |
| Capital note of shareholder | 8 | 32,770 | 32,770 |
| Investments in Subsidiaries | 9 | - | - |
| | | 32,770 | 101,698 |
| FIXED ASSETS | | | |
| Cost | 10 | 542,377 | 507,175 |
| Less - accumulated depreciation | | 235,144 | 222,256 |
| | | 307,233 | 284,919 |
| OTHER ASSETS | | | |
| Goodwill | 9B | 24,737 | 25,878 |

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| | | | |
|---|----|---------|---------|
| Deferred taxes | 22 | 26,559 | 15,108 |
| | | ----- | ----- |
| | | 51,296 | 40,986 |
| | | ----- | ----- |
| | | 892,631 | 937,632 |
| | | ----- | ----- |
| CURRENT LIABILITIES | | | |
| Short-term bank credit | | 66,559 | 42,649 |
| Current maturities of long-term bank loans | 13 | 20,714 | 26,098 |
| Trade payables | 11 | 215,772 | 219,902 |
| Other payables and accrued expenses | 12 | 51,920 | 38,720 |
| | | ----- | ----- |
| | | 354,965 | 327,369 |
| | | ----- | ----- |
| LONG-TERM LIABILITIES | | | |
| Long-term bank loans | 13 | - | 81,851 |
| Deferred taxes | 22 | 38,566 | 37,388 |
| | | ----- | ----- |
| | | 38,566 | 119,239 |
| | | ----- | ----- |
| COMMITMENTS AND CONTINGENT LIABILITIES | 15 | | |
| MINORITY INTEREST | | 58,916 | 54,492 |
| | | ----- | ----- |
| SHAREHOLDERS' EQUITY | | | |
| Share capital | 16 | 29,038 | 29,038 |
| Capital reserves | | 180,414 | 180,414 |
| Translation adjustments relating to foreign held autonomous Subsidiary (2) | | 618 | (3,377) |
| Retained earnings | | 230,114 | 230,457 |
| | | ----- | ----- |
| | | 440,184 | 436,532 |
| | | ----- | ----- |
| | | 892,631 | 937,632 |
| | | ----- | ----- |

(1) See Note 2A(1).

(2) See Note 2B.

T. DAVIS
Chairman of the
Board of Directors

Y. YERUSHALMI
Vice-Chairman of
the Board of Directors

O. ARGOV
Chief Financial

A. SCHOR
Officer Chief Executive

Approval date of the financial statements: March 2, 2006.

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HOGLA-KIMBERLY LTD.
STATEMENTS OF OPERATIONS
(NIS in thousands; except per share data)

CONSOLIDATED
YEAR ENDED DECEMBER 31,

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| | NOTE | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 2 |
|---|------|-------------------------|-------------------------|-------------------------|---------------------|
| | | REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (2) | REPORTED AMOUNTS |
| Net sales | 17 | 1,145,981 | 995,569 | 868,671 | 540,000 |
| Cost of sales | 18 | 820,715 | 719,982 | 621,014 | 452,000 |
| GROSS PROFIT | | 325,266 | 275,587 | 247,657 | 87,000 |
| Selling and marketing expenses | 19 | 202,683 | 193,701 | 130,670 | 13,000 |
| General and administrative expenses | 20 | 56,283 | 41,029 | 39,046 | 5,000 |
| OPERATING PROFIT | | 66,300 | 40,857 | 77,941 | 68,000 |
| Financing income (expenses), net | 21 | 752 | (1,490) | 5,517 | |
| Other income, net | | 176 | 903 | 496 | |
| INCOME BEFORE INCOME TAXES | | 67,228 | 40,270 | 83,954 | 68,000 |
| Income taxes | 22 | 19,527 | 10,244 | 20,566 | 18,000 |
| INCOME AFTER INCOME TAXES | | 47,701 | 30,026 | 63,388 | 49,000 |
| Equity in net earnings (losses) of Subsidiaries | | - | - | - | (6,000) |
| Minority interest in earnings of Subsidiary | | (4,425) | (3,098) | (7,135) | |
| NET INCOME FOR THE YEAR | | 43,276 | 26,928 | 56,253 | 43,000 |
| EARNINGS PER SHARE (IN NIS) | | 5.08 | 3.16 | 6.61 | 5.00 |
| NUMBER OF SHARES USED IN COMPUTATION | | 8,513,473 | 8,513,473 | 8,513,473 | 8,513,473 |

(1) See Note 2A(1).

(2) Adjusted for changes in the exchange rate of the U.S dollar as of December 31, 2003.

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HOGLA-KIMBERLY LTD.
 STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
 (NIS in thousands)

| | SHARE CAPITAL ----- | CAPITAL RESERVES ----- | TRANSLATION ADJUSTMENTS RELATING TO FOREIGN HELD AUTONOMOUS SUBSIDIARY ----- | RETAINED EARNINGS ----- |
|--|---------------------------|------------------------------|--|-------------------------------|
| BALANCE - JANUARY 1, 2003 (ADJUSTED AMOUNTS (3)) | 28,788 | 156,799 | - | 171,141 |
| CHANGES DURING 2003: | | | | |
| Dividend paid | | | | |
| Net income for the year | | | | 56,253 |
| BALANCE - DECEMBER 31, 2003 (ADJUSTED AMOUNTS (3)) | 28,788 | 156,799 | - | 227,394 |
| CHANGES DURING 2004: | | | | |
| Distribution of bonus shares | 250 | 23,615 | | (23,865) |
| Translation adjustments relating to foreign held autonomous Subsidiary(2) | | | (3,377) | |
| Net income for the year | | | | 26,928 |
| BALANCE - DECEMBER 31, 2004 (REPORTED AMOUNTS (1)) | 29,038 | 180,414 | (3,377) | 230,457 |
| CHANGES DURING 2005: | | | | |
| Translation adjustments relating to foreign held autonomous Subsidiary (2) | | | 3,995 | |
| Dividend paid | | | | (43,619) |
| Net income for the year | | | | 43,276 |
| BALANCE - DECEMBER 31, 2005 (REPORTED AMOUNTS (1)) | 29,038 | 180,414 | 618 | 230,114 |

(1) See Note 2A(1).

(2) See Note 2B.

(3) Adjusted for changes in the exchange rate of the U.S dollar as of December 31, 2003.

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HOGLA-KIMBERLY LTD.
STATEMENTS OF CASH FLOWS
(NIS in thousands)

| | CONSOLIDATED | | | Y |
|---|-------------------------|-------------------------|-------------------|---------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | |
| REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (3) | REPORT AMOUNTS | |
| CASH FLOWS - OPERATING ACTIVITIES | | | | |
| Net income | 43,276 | 26,928 | 56,253 | 43,2 |
| Adjustments to reconcile net income to net cash provided by operating activities (Appendix A) | (37,622) | 30,683 | 4,190 | 44,9 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 5,654 | 57,611 | 60,443 | 88,2 |
| CASH FLOWS - INVESTING ACTIVITIES | | | | |
| Withdrawal of long-term bank deposit | 73,648 | 8,138 | 9,195 | |
| Capital notes and loans to Subsidiary | - | - | - | (112,3 |
| Acquisition of fixed assets | (44,634) | (25,191) | (26,953) | (16,3 |
| Proceeds from sale of fixed assets | 293 | 1,827 | 1,092 | 1 |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 29,307 | (15,226) | (16,666) | (128,4 |
| CASH FLOWS - FINANCING ACTIVITIES | | | | |
| Dividend paid | (43,619) | - | (32,843) | (43,6 |
| Long-term loans received | - | 57,672 | 28,949 | |
| Repayment of long-term loans | (94,437) | (15,162) | (24,960) | |
| Short-term bank credit | 21,475 | (1,087) | 1,087 | |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | (116,581) | 41,423 | (27,767) | (43,6 |
| TRANSLATION ADJUSTMENTS OF CASH AND CASH EQUIVALENTS OF FOREIGN HELD AUTONOMOUS SUBSIDIARY (2) | | | | |
| | (193) | (3,784) | - | |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (81,813) | 80,024 | 16,010 | (83,8 |
| CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR | 117,364 | 37,340 | 21,330 | 109,7 |
| CASH AND CASH EQUIVALENTS - END OF YEAR | 35,551 | 117,364 | 37,340 | 25,8 |

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- (1) See Note 2A(1).
(2) See Note 2B.
(3) Adjusted for changes in the exchange rate of the U.S dollar as of December 31, 2003.

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HOGLA-KIMBERLY LTD.
APPENDICES TO STATEMENTS OF CASH FLOWS
(NIS in thousands)

| | CONSOLIDATED | | | |
|---|-------------------------|----------------------|----------------------|---------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 2 |
| REPORTED AMOUNTS (1) | REPORTED AMOUNTS (1) | ADJUSTED AMOUNTS (2) | REPORTED AMOUNTS (1) | |
| A ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES | | | | |
| INCOME AND EXPENSES ITEMS | | | | |
| NOT INVOLVING CASH FLOWS: | | | | |
| Minority interest in earnings of Subsidiary | 4,424 | 3,098 | 7,135 | |
| Equity in net losses (earnings) of Subsidiaries | - | - | | 6,500 |
| Depreciation and amortization | 25,162 | 23,468 | 25,213 | 15,600 |
| Deferred taxes, net | (12,740) | (5,011) | 8,251 | 1,000 |
| Gain from sale of fixed assets | (293) | (1,162) | (482) | (1,000) |
| Effect of exchange rate differences, net | 20 | (1,901) | (2,266) | |
| CHANGES IN ASSETS AND LIABILITIES: | | | | |
| Decrease (increase) in trade receivables | (41,401) | 15,763 | (47,933) | 1,700 |
| Increase in other receivables | (18,974) | (20,938) | (2,115) | (3,000) |
| Increase in inventories | (2,357) | (46,919) | (6,237) | (5,600) |
| Increase in trade payables | 6,167 | 49,624 | 27,544 | 9,900 |
| Net change in balances with related parties | (10,515) | 13,591 | (10,050) | 12,300 |
| Increase (decrease) in other payables and accrued expenses | 12,885 | 1,070 | 5,130 | 3,800 |
| | (37,622) | 30,683 | 4,190 | 44,900 |
| B NON-CASH ACTIVITIES | | | | |
| Acquisition of fixed assets on credit | 37,617 | 18,470 | 8,661 | 7,100 |

- (1) See Note 2A(1).
- (2) Adjusted for changes in the exchange rate of the U.S dollar as of December 31, 2003.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - GENERAL

A. DESCRIPTION

Hogla Kimberly Ltd. ("the Company") and its Subsidiaries are engaged principally in the production and marketing of paper and hygienic products. The Company's results of operations are affected by transactions with shareholders and affiliated companies (see Note 23).

The Company is owned by Kimberly Clark Corp. ("KC" or the "Parent Company") (50.1%) and American-Israeli Paper Mills Ltd. ("AIPM") (49.9%).

B. DEFINITIONS:

| | | |
|-------------------------|---|---|
| THE COMPANY | - | Hogla-Kimberly Ltd. |
| THE GROUP | - | the Company and its Subsidiaries, a list of which is presented in Note 9D. |
| SUBSIDIARIES | - | companies in which the Company exercises over 50% ownership and control, directly or indirectly, and whose financial statements are fully consolidated with those of the Company. |
| RELATED PARTIES | - | as defined by Opinion No. 29 of the Institute of Certified Public Accountants in Israel. |
| INTERESTED PARTIES | - | as defined by the Israeli Securities Regulations (Preparation of Financial Statements), 1993. |
| CONTROLLING SHAREHOLDER | - | as defined by the Israeli Securities Regulations (Presentation of Transactions between a Corporation and its Controlling Shareholder in the Financial Statements), 1996. |
| NIS | - | New Israeli Shekel. |

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| | | |
|-----------------|---|-----------------------------------|
| CPI | - | the Israeli consumer price index. |
| DOLLAR | - | the U.S. dollar. |
| ADJUSTED AMOUNT | - | see Note 2A(1) below. |
| REPORTED AMOUNT | - | see Note 2A(1) below. |

C. USE OF ESTIMATES

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

- D. The financial statements of the Company are prepared in accordance with the Israeli Securities Regulations (Preparation of Annual Financial Statements), 1993.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The following are the principal accounting policies applied in the preparation of the financial statements in a manner consistent with previous years with the exception of the application of the provisions of Standard No. 19 "Income Taxes".

- A. CESSATION OF FINANCIAL STATEMENTS ADJUSTMENT AND CHANGE TO REPORTING IN REPORTED AMOUNTS - STANDARD NO. 12

(1) DEFINITIONS

ADJUSTED AMOUNT - historical nominal amount adjusted for changes in the exchange rate of the U.S. dollar as of December 31, 2003, in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel.

REPORTED AMOUNT - Adjusted Amount plus amounts in nominal terms added subsequent to December 31, 2003, and less amounts subtracted after that date.

(2) GENERAL

In January 2004, Israeli Accounting Standard No. 12 "Cessation of Financial Statements Adjustment" came into effect. Following the initial implementation of Standard No. 12, commencing January 1, 2004, the Group ceased the presentation of its financial statements based on nominal historical cost adjusted for the changes in the exchange rate of the U.S. Dollar in relation to the NIS. Effective with the interim financial statements as of March 31, 2004 and for the reporting periods thereafter, including each of the years

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ended December 31, 2004, and 2005 the Group's financial statements are prepared and presented in Reported Amounts.

Comparative figures included in these financial statements relating to the year ended December 31, 2003 are presented in Adjusted Amounts.

The amounts at which non-monetary items are presented in these financial statements do not necessarily represent their realization value or economic value, but solely their Reported Amount.

The Company's condensed financial information in nominal values, on the basis of which the Company's financial statements in Reported Amounts and Adjusted Amounts were prepared, are presented in Note 25.

(3) PRINCIPLES OF ADJUSTMENT APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIODS ENDED IN DECEMBER 31, 2005 AND 2004

a. BALANCE SHEET ITEMS

Non-monetary items (items whose balances reflect historical value at acquisition or upon establishment) are presented at their Adjusted Amounts plus additions and dispositions occurring during the reporting period. Additions made subsequent to December 31, 2003 and dispositions of items added subsequent to such date, are presented at their historical nominal value. Dispositions of items added on or prior to December 31, 2003 are presented at their Adjusted Amount.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

A. CESSATION OF FINANCIAL STATEMENTS ADJUSTMENT AND CHANGE TO REPORTING IN REPORTED AMOUNTS - STANDARD NO. 12 (cont.)

(3) PRINCIPLES OF ADJUSTMENT APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIODS ENDED IN DECEMBER 31, 2005 AND 2004 (cont.)

A. BALANCE SHEET ITEMS (cont.)

Monetary items (items whose balance sheet amount reflects their current value or realization value at the balance sheet date) are presented at their nominal value as of the balance sheet date.

Investments in Subsidiaries and minority interest are presented based on the financial statements of these companies prepared according to the guidance of Standard No. 12.

B. STATEMENT OF OPERATIONS ITEMS

Income and expenses reflecting transactions, and financial income and expenses, are presented at their nominal value.

Income and expenses deriving from non-monetary items (mainly depreciation and amortization) were presented in a manner corresponding to the presentation of the related non-monetary balance sheet item, as illustrated above.

The Company's share and minority interest in the results of Subsidiaries are determined based on the financial statements of these companies prepared according to the guidance of Standard No. 12.

(4) PRINCIPLES OF ADJUSTMENT APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIODS ENDED THROUGH DECEMBER 31, 2003

STATEMENT OF OPERATIONS ITEMS

Income and expenses reflecting transactions, other than financial income and expenses, were adjusted for changes in the exchange rate of the U.S. dollar from the date of the transaction to the December 31, 2003.

Income and expenses arising from non-monetary items (mainly depreciation, amortization, deferred taxes and changes in inventory) were adjusted in a manner corresponding to the adjustment of the related balance sheet items.

Financing income (expenses), net reflect income and expenses in real terms and include exchange rate differences derived from monetary item.

The Company's share and the minority interest in the results of Subsidiaries were determined based on the dollar adjusted financial statements of these companies.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

B. TRANSLATION OF FOREIGN OPERATIONS' FINANCIAL STATEMENTS - STANDARD NO. 13

In January 2004, Israeli Accounting Standard No. 13 "Effect of Changes in Foreign Exchange Rates" came into effect. This Standard addresses the translation of transactions denominated in foreign currency, as well as the translation of financial statements of a foreign entity, for inclusion in the financial statements of the reporting company. Standard No. 13 supersedes Clarifications No. 8 and 9 to Opinion No. 36 of the Institute of Certified Public Accountants in Israel, which were nullified on the date on which Accounting Standard No. 12 came into effect, as described in A above.

(1) PRINCIPLES OF TRANSLATION OF FINANCIAL STATEMENTS OF FOREIGN HELD AUTONOMOUS SUBSIDIARY APPLICABLE FOR FINANCIAL STATEMENTS

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RELATING TO REPORTING PERIODS ENDED IN DECEMBER 31, 2005 AND 2004

- o Monetary and non-monetary assets and liabilities of the foreign entity are translated at the closing rate.
 - o Statement of operations items and cash flow items of the foreign entity are translated, in general, by the average exchange rate for the reporting period, rather than by the closing rate as was previously required under the applicable accounting literature prior to the date in which Standard No. 13 came into effect (January 1, 2004).
 - o All differences resulting from the translation of the foreign entity's financial statements by the method described above, are included in a separate component of shareholders' equity as "Translation adjustments relating to foreign held autonomous Subsidiary".
 - o Following the implementation of Standard No. 13, commencing January 2004 goodwill derived from an investment made in another entity is to be treated as one of that entity's assets. Accordingly, the goodwill associated with the Group's investment in Ovisan (a Subsidiary located in Turkey) is translated to NIS at the closing rate, rather than at the exchange rate at the date in which said investment was made, as was previously required under the applicable accounting literature in effect through December 31, 2003.
- (2) PRINCIPLES OF TRANSLATION OF FINANCIAL STATEMENTS OF FOREIGN HELD AUTONOMOUS SUBSIDIARY APPLICABLE FOR FINANCIAL STATEMENTS RELATING TO REPORTING PERIODS ENDED IN DECEMBER 31, 2003

The financial statements of Subsidiaries operating abroad were prepared in U.S. dollars and translated into NIS based on the exchange rate of the U.S. dollar as of the balance sheet date.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include consolidation of the financial statements of the Company and all its Subsidiaries. Material inter-company balances and transactions of and between Subsidiaries and the Company have been fully eliminated.

The data included in the consolidated financial statements is based on audited financial statements of the Subsidiaries included therein.

The excess cost of an investment in a Subsidiary in Turkey over the net book value upon acquisition of that Subsidiary is allocated to fixed assets and is amortized at the rate applicable to those assets, or upon

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their realization. The unallocated excess cost reflects goodwill, which is presented in the consolidated balance sheet as "other assets" and amortized by the straight-line method over 15 years due to the unique economic conditions relating to that Subsidiary and the expected economic benefit period from its acquisition. See also I below.

D. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include bank deposits, available for immediate withdrawal, as well as unrestricted short-term deposits with maturities of less than three months from the date of deposit.

E. ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is generally computed as percentage from the relevant balances, on the basis of historical experience, with the addition of a specific provision in respect of accounts, which on management estimate are doubtful of collection.

F. INVENTORIES

Inventories are presented at the lower of cost or market value, with cost determined as follows:

| | | |
|------------------------------------|---|----------------------------------|
| Finished products | - | Based on actual production cost. |
| Raw, auxiliary materials and other | - | Based on moving-average basis. |

G. INVESTMENTS IN SUBSIDIARIES

Investments in Subsidiaries are presented using the equity method based on their audited financial statements. In relation to excess cost of investment in Subsidiary in Turkey, see C above.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

H. FIXED ASSETS

Fixed assets are presented at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method at rates considered adequate to depreciate the assets over their estimated useful lives. Amortization of leasehold improvements is computed over the shorter of the term of the lease, including any option period, where the Company intends to exercise such option, or their useful life.

| | |
|---|-------|
| The annual depreciation and amortization rates are: | % |
| | ----- |
| Buildings | 2-4 |
| Leasehold improvements | 10-25 |
| Machinery and equipment | 5-10 |
| Motor vehicles | 15-20 |
| Office furniture and equipment | 6-33 |

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IMPAIRMENT OF LONG-LIVED ASSETS

Management reviews long-lived assets on a periodic basis, as well as when such a review is required based upon relevant circumstances, to determine whether events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. According to Standard No. 15 of the Israeli Accounting Standards Board, "Impairment of Assets", an asset's recoverable value is the higher of the asset's net selling price and the asset's value in use, the latter being equal to the asset's discounted expected cash flows. If applicable, an impairment charge is recorded at the amount in which the carrying amount of the asset exceeds its recoverable value.

I. OTHER ASSETS - GOODWILL

Goodwill derived from the acquisition of Subsidiary in Turkey is amortized based on the straight line method over 15 years (see also C above). The amortization period and method were determined following the provisions of Standard No. 20 "The amortization Period of Goodwill" which calls for the amortization of goodwill over its useful life, based on a systematic method that should reflect the estimated expected period in which the goodwill is to contribute economic benefits. Impairment examinations and recognition are performed and determined based on the accounting policy outlined in H above.

J. SUPPLIER DISCOUNTS

Ongoing discounts granted by suppliers, as well as year end discounts, in respect of which no commitments to meet given targets are required by the Group, are included in the financial statements upon the execution of purchases that grant the Group said discounts. Supplier discounts contingent upon the Group's fulfillment of certain targets, such as meeting a minimal annual volume (in quantities or amount), or an increase in purchases over previous periods, are included in the financial statements in proportion to the Group's purchases from suppliers during the reported period, which advance the Group towards the stated targets, only if it is expected that those targets will be reached and the discounts can reasonably be estimated. The estimate of meeting the targets is based, inter-alia, on historical experience, Group's relationships established with the suppliers and the estimated volume of purchases during the remaining reported period.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

K. DEFERRED INCOME TAXES

The Group records deferred income taxes in respect of temporary differences between the carrying values of assets and liabilities in the financial statements and their values for tax purposes, including those that result from depreciation differences on leased property and fixed assets. The Group records deferred-tax assets in respect of temporary differences as well as in respect of carry-forward tax losses so long as it is probable that those assets will be realized in the foreseeable future. The deferred income taxes are computed using the tax rates expected to be in effect at realization according to tax laws

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that have been substantively enacted by the balance sheet date.

The computation of deferred income taxes has not taken into account taxes that would have been applicable in case of future realization of investments in Subsidiaries, since the Group does not contemplate such realization in the foreseeable future. Moreover, the computation also excludes deferred taxes in respect of dividend distributions within the Group for cases in which such dividend distributions are expected to be tax-exempt.

L. DIVIDENDS

Dividends proposed or declared subsequent to the balance-sheet date, but prior to the financial statements approval date, are presented as a separate component of shareholders' equity.

M. REVENUE RECOGNITION

Revenues are recognized upon shipment, when title has been transferred and collectibility is reasonably assured.

Revenues are presented net of sales incentives, primarily: bonuses granted to chains as a percentage of their purchases (target bonus); volume discounts; and coupons distributed to customers entitling price discounts.

An accrual for estimated returns and sales incentives, computed primarily on the basis of historical experience, is recorded at the time revenues are recognized and deducted from revenues.

N. EARNINGS PER SHARE

Earnings per share are computed based on the weighted average number of shares outstanding during the year.

O. EXCHANGE RATES AND LINKAGE BASIS

- (1) Balances in foreign currency or linked thereto are included in the financial statements based on the representative exchange rates, as published by the Bank of Israel, that were prevailing at the balance sheet date.
- (2) Exchange-rate differences are charged to operations as incurred.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

O. EXCHANGE RATES AND LINKAGE BASIS (cont.)

- (3) Following are the changes in the representative exchange rate of the U.S. dollar vis-a-vis the NIS and the Turkish Lira, and in the CPI:

REPRESENTATIVE

TURKISH LIRA EXC

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| | EXCHANGE RATE OF THE DOLLAR (NIS PER \$1) ----- | RATE VIS-A-VIS U.S. DOLLAR (TL'000 PER -----) |
|------------------------|--|--|
| December 31, 2005 | 4.603 | 1,351 |
| December 31, 2004 | 4.308 | 1,352 |
| December 31, 2003 | 4.379 | 1,393 |
| INCREASE (DECREASE) | | |
| DURING THE YEAR ENDED: | % | % |
| | --- | --- |
| December 31, 2005 | 6.8 | - |
| December 31, 2004 | (1.6) | (2.9) |
| December 31, 2003 | (7.6) | (15.0) |

P. RECENT ACCOUNTING STANDARDS

(1) ACCOUNTING STANDARD NO.22 "FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION"

In July 2005, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 22, "Financial Instruments: Disclosure and Presentation". Financial instrument under this Standard is, in general, any contract that establishes a financial asset of an entity, or a financial liability or equity instrument of another entity.

This Standard establishes the requirements for presentation of financial instruments in the financial statements and indicates the information that should be disclosed in relation thereto. The presentation requirements relate to the classification of financial instruments as financial assets, financial liabilities or equity instruments. It also deals with the classification of related interest, dividends, losses and gains and to the circumstances under which financial assets and liabilities derived from financial instruments are to be offset. The Standard requires disclosure of information relating to factors affecting the amount, timing and certainty of the entity's future cash flows relating to financial instruments and accounting policy implemented in respect of these instruments. The Standard also establishes requirements for disclosure of information about the nature and the extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them and management's policies for the oversight of those risks.

Standard No. 22 is effective for financial statements for periods commencing January 1, 2006 or thereafter. The initial adoption of the Standard will be accounted for prospectively. Comparative financial statements for prior periods shall not be adjusted. The Standard's effect on the Group's financial position and results of operations is not expected to be significant.

HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

P. RECENT ACCOUNTING STANDARDS (cont.)

(2) ACCOUNTING STANDARD NO.24 "STOCK-BASED COMPENSATION"

In September 2005, the Israeli Accounting Standards Board published Accounting Standard No. 24 "Share-Based Payment" (the "Standard"), which calls for the recognition in the financial statements of share-based payment transactions. Such transactions include transactions with employees and related parties to be settled by cash, by other assets, or by equity instruments. Consequently, amongst other matters, costs associated with grants of shares and options to employees will be expensed over the vesting period of each grant. These costs will be determined based on the fair value of the awards at each grant date. The Standard establishes guidelines for measuring each award based on the settlement terms (either by cash or equity instrument). The Standard also establishes certain disclosure requirements relating to share-based payment.

The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter (initial adoption is recommended). The application of the Standard is not expected to affect the Company's financial position and results of operations.

(3) ACCOUNTING STANDARD NO. 21 "EARNINGS PER SHARE"

In February 2006, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 21, "Earnings Per Share" (the "Standard"). With the initial adoption of the Standard, Opinion No. 55 of the Institute of Certified Public Accountants in Israel - Earnings per share will be cancelled. The Standard prescribes that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. The basic earnings per share shall be calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the reported period.

For the purpose of calculating diluted earnings per share, an entity shall adjust profit or loss attributable to ordinary equity holders of the parent entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.

The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter. The initial adoption of the Standard will be accounted for retrospectively and comparative Earnings per share data for prior periods shall be adjusted. The application of the Standard is not expected to

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materially affect the Company's Earnings per share data.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (cont.)

P. RECENT ACCOUNTING STANDARDS (cont.)

(4) ACCOUNTING STANDARD NO. 25 "REVENUES"

In February 2006, the Israeli Accounting Standards Board approved for publication Accounting Standard No. 25, "Revenues" (the "Standard").

This Standard establishes the requirements for recognition criteria, measurement, disclosure and presentation of revenues arising from sale of goods, rendering of services and from the use by others of entity assets yielding interest, royalties and dividends. This Standard prescribes that revenue shall be measured at the fair value of the consideration received or receivable.

The Standard is effective for financial statements for periods commencing January 1, 2006 or thereafter. Assets and liabilities included in the financial statements as of December 31, 2005 in different amounts from those that would have been presented if the standard's requirements were applied will be adjusted on January 1, 2006 to the amounts to be recognized in accordance with the Standard's guidelines. The results of the initial adoption of the Standard as at January 1, 2006 shall be accounted for by the cumulative effect of a change in accounting method.

The company is currently evaluating the impact, if any, of the adoption of the Standard on its financial position and results of operations.

NOTE 3 - CASH AND CASH EQUIVALENTS

| | CONSOLIDATED | | |
|--|------------------|----------|----------|
| | DECEMBER 31 | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 |
| | REPORTED | REPORTED | REPORTED |
| | AMOUNTS | AMOUNTS | AMOUNTS |
| | NIS IN THOUSANDS | | |
| In NIS | 1,086 | 875 | |
| In foreign currencies (Primarily the U.S. dollar) | 34,465 | 116,489 | |

35,551 117,364 2

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 4 - TRADE RECEIVABLES

| | | CONSOLIDATED | | |
|----------|--|------------------|----------|-------|
| | | DECEMBER 31 | | |
| | | 2 0 0 5 | 2 0 0 4 | 2 |
| | | ----- | ----- | ----- |
| | | REPORTED | REPORTED | REP |
| | | AMOUNTS | AMOUNTS | AM |
| | | ----- | ----- | ----- |
| | | NIS IN THOUSANDS | | |
| | | ----- | ----- | ----- |
| Domestic | - Open accounts | 184,952 | 159,693 | |
| | - Checks receivable | 36,077 | 33,013 | |
| | - Related parties (*) | 782 | 598 | 11 |
| | | ----- | ----- | ----- |
| | | 221,811 | 193,304 | 11 |
| | | ----- | ----- | ----- |
| Foreign | - Open accounts | 54,364 | 25,971 | |
| | - Related parties | 668 | 775 | |
| | | ----- | ----- | ----- |
| | | 55,032 | 26,746 | |
| | | ----- | ----- | ----- |
| | Less - allowance for doubtful accounts | 276,843 | 220,050 | 12 |
| | | 18,944 | 5,661 | |
| | | ----- | ----- | ----- |
| | | 257,899 | 214,389 | 12 |
| | | ----- | ----- | ----- |

(*) Balances with Israeli related parties are linked to the CPI and bear 4% annual interest

The Company's products are marketed principally by its Subsidiaries.

NOTE 5 - OTHER RECEIVABLES

| | | CONSOLIDATED | | |
|--|--|--------------|---------|-------|
| | | DECEMBER 31 | | |
| | | 2 0 0 5 | 2 0 0 4 | 2 |
| | | ----- | ----- | ----- |

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| | REPORTED AMOUNTS | REPORTED AMOUNTS | REP AM |
|---------------------------|---------------------|---------------------|-----------|
| NIS IN THOUSANDS | | | |
| Deferred taxes (Note 22D) | 8,207 | 4,611 | |
| Prepaid expenses | 1,775 | 2,175 | |
| Advances to suppliers | 7,549 | 615 | |
| Value Added Taxes | 24,345 | 15,970 | |
| Income tax advances, net | 16,230 | 10,973 | 1 |
| Loans to employees | 509 | 600 | |
| Other | 1,190 | 781 | |
| | 59,805 | 35,725 | 1 |

NOTE 6 - INVENTORIES

| | CONSOLIDATED | | |
|-----------------------------|---------------------|---------------------|-----------|
| | DECEMBER 31 | | |
| | 2 0 0 5 | 2 0 0 4 | 2 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | REP AM |
| NIS IN THOUSANDS | | | |
| Raw and auxiliary materials | 71,426 | 67,765 | 3 |
| Finished goods | 57,741 | 56,872 | 1 |
| Spare parts and other | 18,910 | 17,914 | 1 |
| | 148,077 | 142,551 | 7 |

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 7 - LONG-TERM BANK DEPOSIT

The US dollar linked deposit was held as collateral for long-term loan received by Subsidiary (see Note 15C) that was fully repaid on December 30, 2005. Consequently, the Group withdrew the deposit at the same time.

NOTE 8 - CAPITAL NOTE OF SHAREHOLDER

The capital note of AIPM, denominated in NIS, is not linked and does not bear interest. Repayment date will be mutually agreed upon.

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- C. INVESTMENT IN KIMBERLI CLARK TUKETIM MALLARI SANAYI VE TICARET A.(S).
("KCTR") (FORMERLY: OVISAN)

As of December 31, 2005, the Group's investment in KCTR (a Turkish Subsidiary) amounted to NIS 4,358 thousand (including goodwill - see above). In the recent years KCTR incurred significant losses from operations.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 9 - INVESTMENTS IN SUBSIDIARIES (cont.)

- C. INVESTMENT IN KIMBERLI CLARK TUKETIM MALLARI SANAYI VE TICARET A.(S).
("KCTR") (FORMERLY: OVISAN) (cont.)

In addition to the NIS 116.5 million the Company provided KCTR in 2005 for the continuation of its on going operations, the Company has committed to financially support KCTR in 2006. Such finance support may be granted to KCTR either by cash injection, long-term loans, or guaranteed if required so by banks according to the financing needs of KCTR. The ability of KCTR to continue as a stand-alone business unit depends significantly on the occurrence of its multiple-year working plan and on said financial support by the Company.

D. CONSOLIDATED SUBSIDIARIES

The consolidated financial statements as of December 31, 2005, include the financial statements of the following Subsidiaries:

Rakefet Marketing and Trade Services Ltd. ("Rakefet")
SUBSIDIARIES OF RAKEFET:

Hogla-Kimberly Marketing Ltd. ("Marketing")
Shikma Ltd. ("Shikma")
SUBSIDIARY OF SHIKMA
Kimberli Clark Tuketim Mallari Sanayi
Ve Ticaret A.(S). ("KCTR")
Mollet Marketing Ltd. ("Mollet")
H-K Overseas (Holland) B.V.
SUBSIDIARY OF H-K OVERSEAS (HOLLAND) B.V.:

Hogla-Kimberly Holding Anonim Sirketi (***)

(*) The remaining ownership and control of Rakefet are held by

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AIPM Group (10.1%) and by KC (10.2%).

(**) The remaining ownership and control of Marketing and Shikma are held by the Company.

(***) During the year ended December 31, 2005 the company was dormant.

E. SUPPLEMENTAL DATA

On December 30, 2005, H-K Overseas (Holland) B.V sold the entirety of its holdings in KCTR to Shikma Ltd. in consideration for NIS 70,826. The consideration amount was determined based on an independent appraisal, and reflects a fair value of the transaction.

In December 2005, the Company filed a request with the Israeli Tax Authority for the merger of Rakefet and Shikma into the Company. According to the merger request, the assets and liabilities of Shikma and Rakefet will be merged into those of the Company, and the Company will issue shares to its shareholders, KC and AIPM, in respect of their holdings in Rakefet. As of the approval date of the financial statements, the Company's request has not yet been approved by the Israeli Tax Authority.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 10 - FIXED ASSETS

| CONSOLIDATED | BUILDINGS (1) | LEASEHOLD IMPROVEMENTS | MACHINERY AND EQUIPMENT | MOTOR VEHICLES |
|---|-----------------------------------|---------------------------|-------------------------------|-------------------|
| ----- | ----- | ----- | ----- | ----- |
| COST: | NIS IN THOUSANDS; REPORTED AMOUNT | | | |
| ----- | ----- | ----- | ----- | ----- |
| BALANCE - JANUARY 1, 2005 | 56,884 | 9,713 | 412,663 | 14,020 |
| Changes during 2005: | | | | |
| Additions | 815 | 1,189 | 37,090 | 92 |
| Dispositions | - | - | (10,066) | (76) |
| Foreign currency translation adjustments | 2,139 | 22 | 2,002 | 13 |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2005 | 59,838 | 10,924 | 441,711 | 14,319 |
| | ----- | ----- | ----- | ----- |
| ACCUMULATED DEPRECIATION: | | | | |
| BALANCE - JANUARY 1, 2005 | 17,821 | 4,809 | 178,265 | 11,720 |
| Changes during 2005: | | | | |
| Additions | 1,074 | 573 | 17,792 | 1,400 |
| Dispositions | - | - | (10,066) | (76) |
| Foreign currency translation adjustments | 299 | - | 879 | 11 |
| | ----- | ----- | ----- | ----- |

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| | | | | |
|-----------------------------|--------|-------|----------|-------|
| BALANCE - DECEMBER 31, 2005 | 19,194 | 5,383 | 186,848 | 12,48 |
| | ----- | ----- | ----- | ----- |
| NET BOOK VALUE: | | | | |
| December 31, 2005 | 40,644 | 5,541 | 254,863 | 1,83 |
| | ----- | ----- | ----- | ----- |
| December 31, 2004 | 40,247 | 3,441 | 235,674 | 2,31 |
| | ----- | ----- | ----- | ----- |
| COMPANY | | | | |
| COST: | | | | |
| BALANCE - JANUARY 1, 2005 | 25,291 | 7,611 | 367,247 | 2,32 |
| Changes during 2005: | | | | |
| Additions | - | 59 | 22,672 | 42 |
| Dispositions | - | - | (10,066) | (44 |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2005 | 25,291 | 7,670 | 379,853 | 2,30 |
| | ----- | ----- | ----- | ----- |
| ACCUMULATED DEPRECIATION: | | | | |
| BALANCE - JANUARY 1, 2005 | 12,763 | 4,074 | 152,372 | 2,22 |
| Changes during 2005: | | | | |
| Additions | 473 | 274 | 14,569 | 3 |
| Dispositions | - | - | (10,066) | (44 |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2005 | 13,236 | 4,348 | 156,875 | 1,81 |
| | ----- | ----- | ----- | ----- |
| NET BOOK VALUE: | | | | |
| December 31, 2005 | 12,055 | 3,322 | 222,978 | 49 |
| | ----- | ----- | ----- | ----- |
| December 31, 2004 | 12,528 | 3,537 | 214,875 | 10 |
| | ----- | ----- | ----- | ----- |

- (1) Company - leasehold improvements of industrial buildings on lands leased by the Company from AIPM (until 2005). The lease agreements are renewed annually.
- (2) The majority of the Group's fixed assets are located in Israel with the remaining located in Turkey.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 11 - TRADE PAYABLES

CONSOLIDATED

DECEMBER 31,

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| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 |
|----------------------|------------------|------------------|------------------|
| | REPORTED AMOUNTS | REPORTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | NIS |
| In Israeli currency: | | | |
| Open accounts | 114,140 | 94,218 | 51,290 |
| Related parties | 19,690 | 23,124 | 205,030 |
| In foreign currency: | | | |
| Open accounts | 71,935 | 86,719 | 42,170 |
| Related parties | 10,007 | 15,931 | 5,200 |
| | 215,772 | 219,902 | 303,710 |

NOTE 12 - OTHER PAYABLES AND ACCRUED EXPENSES

| | CONSOLIDATED | | |
|--------------------------------------|------------------|------------------|------------------|
| | DECEMBER 31, | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | NIS |
| Accrued income taxes, | | | |
| net of advances | 12,621 | 10,464 | |
| Accrued payroll and related expenses | 24,101 | 22,195 | 11,300 |
| Value Added Tax | 5,462 | 2,695 | 2,300 |
| Advances from customers | 1,099 | 726 | |
| Other | 8,367 | 2,640 | 2,200 |
| | 51,920 | 38,720 | 15,900 |

NOTE 13 - LONG-TERM BANK LOANS

| INTEREST RATE | CONSOLIDATED |
|---------------|------------------|
| ----- | DECEMBER 31, |
| % (*) | 2 0 0 5 |
| ----- | REPORTED AMOUNTS |
| | NIS IN THOUSANDS |

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| | | |
|---------------------------|------------------|--------|
| In U.S. dollar | Libor +1.22-1.63 | 20,714 |
| Less - current maturities | | 20,714 |
| | | ----- |
| | | - |
| | | ----- |

NOTE 14 - SEVERANCE PAY

Obligations of the Group for severance pay to its employees are covered by current payments to pension and severance funds. Accumulated amounts in the pension and severance funds are not under the control or administration of the Group, and accordingly, neither those amounts nor the corresponding accruals are reflected in the financial statements.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 15 - COMMITMENTS AND CONTINGENT LIABILITIES

A. COMMITMENTS

- (1) The Group is obligated to pay royalties to a shareholder - see also Note 23B.
- (2) The Company and its Subsidiaries lease certain of their facilities under operating leases for varying periods with renewal options. Future minimum lease rentals as of December 31, 2005 are as follows:

| | CONSOLIDATED | COMPANY |
|---------------------|------------------|---------|
| | ----- | ----- |
| | NIS IN THOUSANDS | |
| | ----- | ----- |
| 2006 | 14,695 | 6,585 |
| 2007 | 8,399 | 766 |
| 2008 | 7,548 | 669 |
| 2009 | 7,548 | 669 |
| 2010 and thereafter | 87,074 | 1,342 |
| | ----- | ----- |
| | 125,263 | 10,031 |
| | ----- | ----- |

B. GUARANTEES

- (1) The Company is contingently liable in respect of a guarantee securing bank loans provided to a Subsidiary, the balance of which as of December 31, 2005 amounted to NIS 87,273 thousand.
- (2) As part of their normal course of business, the Subsidiaries provided third parties with bank guarantees for contract performance, the balance of which as of December 31, 2005 amounted to NIS 2,636 thousand.

C. LEGAL PROCEEDINGS

- (1) The Company received on December 7, 2003 a claim and a petition that was filed in the Tel-Aviv district court for the approval of a class action against the Company. According to the petition the Company has reduced the number of units of

diapers in a package and thus misled the public according to the Israeli Consumer Protection Act. The plaintiffs estimate the scope of the class action to be NIS 18 million. The Company rejects the claim and intends to defend itself against the action. Based on the opinion of the Company's legal counsel for this matter, the Company's management is unable, at this stage, to estimate the possible outcome of the lawsuit. However, based on the legal counsels' opinion, the Company's management estimates that the Company has valid arguments to oppose the lawsuit and reasonable basis for denying it from being recognized as a class action. Therefore, no provision was recorded in the financial statements in respect of this claim.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 15 - COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

C. LEGAL PROCEEDINGS (cont.)

- (2) In February 2004, a former customer filed a lawsuit against the Company. This lawsuit is a part from multi-suppliers lawsuit, filed by the customer claiming for one billion NIS from the Company and each other supplier for alleged damages. The customer asked for discharge from legal fee and the request was denied. Due to the preliminary stage of the proceedings, management is unable to estimate the possible outcome of the lawsuit. However, based on the Company's legal counsels, management estimates that the Company has valid arguments to oppose the lawsuit. Therefore, no provision was recorded in the financial statements relating to this lawsuit.

- (3) In July 2005, Clubmarket Marketing Chains Ltd. ("Clubmarket"), a customer of the Company and one of the largest retail groups in Israel, applied for the regional court in Tel-Aviv ("Court") for a staying of procedures by creditors. The court protection was granted until August 17, 2005. As a result, in the second quarter of 2005 a provision of NIS 10.6 million for doubtful accounts was recorded, which is included in the general and administrative expenses line item. In the third quarter of 2005, Shufersal, Israel's biggest retail chain, won a bid supervised by the Court for the purchase of the stores, operations and inventories of Clubmarket. In December 2005, the Court approved a creditors settlement submitted by the trustees, according to which, amongst other matters, the Company is to receive 51% of Clubmarket's debt to the Company. The settlement is subject to various conditions, including reaching an understanding between the trustees and the Company about the exact amount Clubmarket is to pay the Company, and crystallizing certain material issues between the trustees and the Israeli Tax Authorities. Due to said uncertainties relating to the exact amounts to be paid, and based on the opinions of the Company's legal advisors for this matter, management cannot estimate, at this stage, the exact payout of Clubmarket's debt to the Company as a result of said settlement. The remaining net balance of Clubmarket as of December 31, 2005, that is in excess of the doubtful accounts

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provision recorded in the financial statements, is approximately NIS 5.3 million (excluding VAT), which represents approximately 25% of the balance as of such date.

NOTE 16 - SHARE CAPITAL

A. COMPOSITION OF SHARE CAPITAL IN NOMINAL NIS AS OF DECEMBER 31, 2005 AND 2004:

| | NUMBER OF SHARES | |
|---------------------------------------|------------------|--------------------------|
| | AUTHORIZED | ISSUED AND FULLY PAID UP |
| Ordinary Shares of NIS 1.00 par value | 11,000,000 | 8,263,473 |

B. In connection with the Company's approved enterprise program, following the Company's Board of Directors decision in September 2004, the Company's issued its shareholders in 2004, 250,000 bonus shares with a premium of NIS 94.46 for each share.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

C. Holders of ordinary shares are entitled to participate equally in the payment of cash dividends and bonus share (stock dividend) distributions and, in the event of the liquidation of the Company, in the distribution of assets after satisfaction of liabilities to creditors. Each ordinary share is entitled to one vote on all matters to be voted on by shareholders.

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NOTE 17 - NET SALES

| | CONSOLIDATED | |
|--|--------------|---------|
| | 2005 | 2004 |
| A. SALES FROM COMMERCIAL OPERATIONS | 227,960 | 238,966 |
| B. FOREIGN SALES (PRINCIPALLY IN TURKEY) | 173,966 | 96,100 |

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| | | | | |
|----|--------------------------------------|------|-----|-----|
| C. | SALES TO MAJOR CUSTOMERS | % | --- | --- |
| | (as percentage from total net sales) | | | |
| | Customer A | 9.8 | | 9 |
| | Customer B | 10.7 | | 11 |

NOTE 18 - COST OF SALES

| | CONSOLIDATED | | | |
|---------------------------------------|-------------------------|---------------------|---------------------|---------------------|
| | YEAR ENDED DECEMBER 31, | | | YEA |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| Purchases (*) | 614,281 | 558,155 | 446,008 | 276,319 |
| Salaries and related expenses | 88,175 | 85,167 | 67,516 | 67,792 |
| Manufacturing expenses | 100,371 | 87,201 | 79,810 | 93,487 |
| Depreciation | 18,757 | 17,244 | 18,221 | 15,568 |
| | 821,298 | 747,767 | 611,555 | 453,166 |
| Change in finished goods inventory | (583) | (27,785) | 9,459 | (472) |
| | 820,715 | 719,982 | 621,014 | 452,694 |
| | ===== | ===== | ===== | ===== |

(*) The purchases of the Company are related to manufacturing operations. Consolidated purchases in excess of Company purchases relate principally to commercial operations.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 19 - SELLING EXPENSES

| | CONSOLIDATED | | | |
|--|-------------------------|---------------------|---------------------|---------------------|
| | YEAR ENDED DECEMBER 31, | | | YEA |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |

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| | | | | |
|---|---------|---------|---------|--------|
| Salaries and related expenses | 61,574 | 57,003 | 46,887 | - |
| Maintenance and transportation expenses | 40,153 | 42,283 | 26,596 | 8,925 |
| Advertising and sales promotion | 49,375 | 59,264 | 30,482 | 2,577 |
| Commissions to distributors | 19,067 | 5,130 | 4,571 | - |
| Royalties to a shareholder | 22,703 | 21,318 | 15,891 | 2,157 |
| Depreciation | 3,022 | 3,687 | 3,778 | 38 |
| Other | 5,789 | 5,016 | 2,825 | 11 |
| | ----- | ----- | ----- | ----- |
| | 202,683 | 193,701 | 130,670 | 13,708 |
| | ===== | ===== | ===== | ===== |

NOTE 20 - GENERAL AND ADMINISTRATIVE EXPENSES

| | CONSOLIDATED | | | |
|---|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| Salaries and related expenses | 19,927 | 15,837 | 18,283 | 2,699 |
| Administrative and computer services | 9,189 | 10,150 | 6,287 | 1,417 |
| Services provided by Shareholder | 1,194 | 1,188 | 1,161 | 199 |
| Office maintenance | 4,804 | 4,632 | 5,376 | 198 |
| Depreciation | 560 | 522 | 718 | - |
| Goodwill amortization | 3,030 | 2,832 | 2,768 | - |
| Provision for doubtful accounts (see Note 15C(3)) | 10,327 | 2,144 | 1,562 | - |
| Other | 7,252 | 3,724 | 2,891 | 527 |
| | ----- | ----- | ----- | ----- |
| | 56,283 | 41,029 | 39,046 | 5,040 |
| | ===== | ===== | ===== | ===== |

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 21 - FINANCING INCOME (EXPENSES), NET

| | CONSOLIDATED | | | |
|--|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| | ----- | ----- | ----- | ----- |
| | | | | |
| | ----- | ----- | ----- | ----- |

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| | | | | |
|--|---------|---------|---------|-------|
| Interest on long-term bank loans | (6,330) | (2,673) | (2,111) | - |
| | ===== | ===== | ===== | ===== |
| Exchange rate differences | 3,092 | - | 2,476 | 2,308 |
| | ===== | ===== | ===== | ===== |
| Interest from long-term and short-term bank deposits | 3,929 | 1,464 | 1,357 | 1,300 |
| | ===== | ===== | ===== | ===== |

The majority of the remaining balances of the consolidated financial income (expenses) for each of the periods presented are comprised of exchange rate differences.

NOTE 22 - INCOME TAXES

| | CONSOLIDATED | | | |
|---------------------------------|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | YEAR |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| A. COMPOSITION | | | | |
| Current taxes | 32,267 | 16,258 | 10,878 | 17,866 |
| Taxes in respect of prior years | - | (1,003) | 1,437 | - |
| Deferred taxes - D. below | (12,740) | (5,011) | 8,251 | 1,029 |
| | ----- | ----- | ----- | ----- |
| | 19,527 | 10,244 | 20,566 | 18,895 |
| | ===== | ===== | ===== | ===== |

B. The Company and its Israeli Subsidiaries are subject to the Income Tax Ordinance and the Income Tax Law (Inflationary Adjustments), 1985. Non-Israeli Subsidiaries are subject to income tax provisions of their home country. The Company is an industrial company in conformity with the Law for the Encouragement of Industry (Taxes), 1969. The principal benefit that the Company is entitled to under this law is accelerated depreciation rates and reduced tax rates.

During 2002, the Company's program for the establishment of a new facility for manufacturing paper was granted Approved Enterprise status in accordance with the Law for the Encouragement of Capital Investments, 1959, under "alternative benefits" track. The approval program is for total investments of approximately NIS 80 million. According to the terms of the program, income derived from the Approved Enterprise will be tax-exempt for a period of 10 years commencing in the year in which the program was substantially completed. Distribution of dividends from tax exempt profits of the Approved Enterprise will be subject to income tax at a rate equal to the income tax rate of the Approved Enterprise had the Company not elected the alternative

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benefits track. The Company completed the investments relating to the new facility and commenced its operations during 2003.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 22 - INCOME TAXES (cont.)

C. RECONCILIATION OF THE STATUTORY TAX RATE TO THE EFFECTIVE TAX RATE:

| | CONSOLIDATED | | | YEARS |
|--|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| Income before income taxes | 67,228 | 40,270 | 83,954 | 68,747 |
| Statutory tax rate (see E below) | 34% | 35% | 36% | 34% |
| Tax computed by statutory tax rate- | 22,858 | 14,095 | 30,223 | 23,374 |
| TAX INCREMENTS (SAVINGS) DUE TO: | | | | |
| Income in reduced tax rate | 1,112 | (161) | (1,185) | - |
| Non-deductible expenses | 4,352 | 1,454 | 1,874 | 40 |
| Non-taxable income | (1,144) | (455) | (65) | - |
| Unrecorded deferred taxes in connection with tax loss carry forward | 450 | - | - | - |
| Utilization of prior years unrecorded deferred taxes in connection with tax loss carry forward | - | - | (3,471) | - |
| Unrecorded deferred taxes in connection with submitting consolidated tax returns | - | - | - | - |
| Reduction in corporate tax rates (E. below) | (5,361) | (1,594) | - | (5,476) |
| Differences arising from basis of measurement (*) | (1,664) | (2,821) | (7,629) | 813 |
| Income taxes for prior years | - | (1,003) | 1,437 | - |
| Other differences, net | (1,076) | 729 | (618) | 144 |
| | 19,527 | 10,244 | 20,566 | 18,895 |

(*) For 2005 and 2004 - In Israel, Reported Amounts (NIS) for financial reporting purposes vis-a-vis the consumer price index for tax purposes; In Turkey - U.S. dollar for financial

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reporting purposes vis-a-vis the Turkish Lira for tax purposes.

For 2003 - U.S. dollar for financial reporting purposes vis-a-vis the Consumer Price Index in Israel and the Turkish Lira in Turkey for tax purposes.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 22 - INCOME TAXES (cont.)

D. DEFERRED TAXES

| | CONSOLIDATED | | | YEARS |
|--|-------------------------|------------------|------------------|------------------|
| | YEAR ENDED DECEMBER 31, | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | |
| Balance as of beginning of year | 17,669 | 23,910 | 15,659 | 33,481 |
| Changes during the year | (7,473) | (3,417) | 8,251 | 6,505 |
| Adjustment due to change in income tax rates | (5,361) | (1,594) | - | (5,476) |
| Foreign currency translation adjustments | (1,035) | (1,230) | - | - |
| Balance as of end of year | 3,800 | 17,669 | 23,910 | 34,510 |

| | CONSOLIDATED | | |
|--|------------------|------------------|------------------|
| | DECEMBER 31, | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | |

DEFERRED TAXES ARE PRESENTED IN THE BALANCE SHEETS AS FOLLOWS:

Long-term liabilities (in respect of

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| | | | |
|--|----------|----------|-------|
| depreciable assets) | 38,566 | 37,388 | 36, |
| Other receivables (in respect of temporary differences) - Note 5 | (8,207) | (4,611) | (1, |
| Other assets | (26,559) | (15,108) | --- |
| | ----- | ----- | --- |
| | 3,800 | 17,669 | 34, |
| | ===== | ===== | ===== |

For 2005 - Deferred taxes were computed at rates between 26.5%-33%, primarily - 26.5%.

For 2004 - Deferred taxes were computed at rates between 30%-34%, primarily - 30%.

E. REDUCTION OF CORPORATE TAX RATES

In July 2005, the Israeli Knesset passed the Law for Amending the Income Tax Ordinance (No. 147), 2005, according to which commencing in 2006 the corporate income-tax rate would be gradually reduced, for which a 31% tax rate was established, through 2010, in respect of which a 25% tax rate was established. For the effect of the reduction in tax rates, see D. above.

F. The Company and one of its subsidiaries are "Industrial Companies" as defined in the Israeli Law for the Encouragement of Industry (Taxes)-1969. Based on this Law, the Company and that subsidiary file consolidated tax returns.

G. The Company and its Israeli Subsidiaries possess final tax assessments through 2001.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 23 - RELATED PARTIES AND INTERESTED PARTIES

A. BALANCES WITH RELATED PARTIES

| | CONSOLIDATED | | |
|------------------------------|------------------|----------|----------|
| | DECEMBER 31, | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 |
| | ----- | ----- | ----- |
| | REPORTED | REPORTED | REPORTED |
| | AMOUNTS | AMOUNTS | AMOUNTS |
| | ----- | ----- | ----- |
| | NIS IN THOUSANDS | | |
| | ----- | ----- | ----- |
| Trade receivables (*) | 1,450 | 1,373 | 1,373 |
| Capital note - shareholder | 32,770 | 32,770 | 32,770 |
| Loans - Subsidiaries | - | - | 46,000 |
| Capital notes - Subsidiaries | - | - | 70,000 |
| | ===== | ===== | ===== |

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| | | | |
|--------------------|--------|--------|-------|
| Trade payables (*) | 29,536 | 39,055 | 22, |
| | ===== | ===== | ===== |

(*) Company - excludes Subsidiaries in Israel. See also Notes 4 and 11.

B. TRANSACTIONS WITH RELATED PARTIES AND SUBSIDIARIES

| | CONSOLIDATED | | | YEA | |
|---|-------------------------|------------------|------------------|---------|------------------|
| | YEAR ENDED DECEMBER 31, | | | | |
| | 2 0 0 5 | 2 0 0 4 | 2 0 0 3 | | 2 0 0 5 |
| | REPORTED AMOUNTS | REPORTED AMOUNTS | ADJUSTED AMOUNTS | | REPORTED AMOUNTS |
| | NIS IN THOUSANDS | | | | |
| Sales to related parties | 13,793 | 12,565 | 6,103 | 8,289 | |
| Sales to Subsidiaries | - | - | - | 508,355 | |
| Cost of sales | 157,073 | 162,096 | 169,469 | 73,951 | |
| Royalties | 23,703 | 21,318 | 15,891 | 2,157 | |
| General and administrative expenses (*) | 9,381 | 8,969 | 8,201 | 1,615 | |
| Financing income, net (*) | - | - | 2,548 | - | |

(*) Company - excludes Subsidiaries in Israel.

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 24 - DISCLOSURE AND PRESENTATION OF FINANCIAL INSTRUMENTS

A. CREDIT RISK

The revenues of the Group's principal Subsidiaries are derived from two major customers and a large number of smaller customers. Management regularly monitors the balance of trade receivables and the financial statements include an allowance for doubtful accounts based on management's estimation. Taking the aforementioned into consideration, the exposure to credit risk from trade receivables is immaterial.

Cash and cash equivalents and long-term deposits are deposited with major banks in Israel and abroad. Therefore, it is not expected that

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such banks will fail to meet their obligations.

B. FAIR VALUE OF FINANCIAL INSTRUMENTS

The financial instruments of the Group consist primarily of non-derivative assets and liabilities. Non-derivative assets include cash and cash equivalents, receivables and other current assets. Non-derivative liabilities include trade payables and other current liabilities. Due to the nature of these financial instruments, their fair value, generally, is identical or close to the value at which they are presented in the financial statements, unless stated otherwise.

Due to the fact that as of December 31, 2005, the terms of the capital note of shareholder do not include determined payment dates, fair value based on present values cannot be established. Accordingly, the fair value of the capital note is not disclosed in the financial statements.

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HOGLA-KIMBERLY LTD. NOTES TO FINANCIAL STATEMENTS

NOTE 25 - COMPANY'S FINANCIAL INFORMATION IN NOMINAL VALUES FOR TAX PURPOSES

A. BALANCE SHEETS

| | COMPAN |
|-------------------------------------|------------|
| | DECEMBER |
| | 2 0 0 5 |
| | NIS IN THO |
| CURRENT ASSETS | |
| Cash and cash equivalents | 25,831 |
| Trade receivables | 120,427 |
| Other receivables | 12,739 |
| Inventories | 76,840 |
| | 235,837 |
| LONG-TERM INVESTMENTS | |
| Capital note of shareholder | 32,770 |
| Investments in Subsidiaries | 276,289 |
| | 309,059 |
| FIXED ASSETS, NET | |
| | 229,378 |
| | 774,274 |
| | ===== |
| CURRENT LIABILITIES | |
| Short-term bank credit | - |
| Trade payables | 303,710 |
| Other payables and accrued expenses | 16,115 |

SHAREHOLDERS' EQUITY

319,825

454,449

774,274
=====

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HOGLA-KIMBERLY LTD.
NOTES TO FINANCIAL STATEMENTS

NOTE 25 - COMPANY'S FINANCIAL INFORMATION IN NOMINAL VALUES FOR TAX PURPOSES (cont.)

B. STATEMENT OF OPERATIONS

| | YEAR ENDED DECE | |
|---|-----------------|---------|
| | 2 0 0 5 | 2 0 0 |
| | ----- | |
| | NIS IN THOU | |
| | ----- | |
| Net sales | 540,002 | 479,32 |
| Cost of sales | 451,703 | 392,37 |
| | ----- | ----- |
| GROSS PROFIT | 88,299 | 86,94 |
| Selling expenses | 13,861 | 15,28 |
| General and administrative expenses | 5,040 | 4,98 |
| | ----- | ----- |
| OPERATING PROFIT | 69,398 | 66,67 |
| Financing income (expenses), net | (189) | (4,541) |
| Other income, net | (153) | 28 |
| | ----- | ----- |
| INCOME BEFORE INCOME TAXES | 69,740 | 62,41 |
| Income taxes | 17,866 | 9,11 |
| | ----- | ----- |
| INCOME AFTER INCOME TAXES | 51,874 | 53,30 |
| Equity in net earnings of Subsidiaries | (9,466) | 16,66 |
| | ----- | ----- |
| NET INCOME FOR THE YEAR | 42,408 | 36,64 |

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HOGLA-KIMBERLY LTD.

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NOTES TO FINANCIAL STATEMENTS

NOTE 25 - COMPANY'S FINANCIAL INFORMATION IN NOMINAL VALUES FOR TAX PURPOSES (cont.)

C. STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | SHARE CAPITAL ----- | CAPITAL RESERVES ----- | TRANSLATION ADJUSTMENTS RELATING TO FOREIGN HELD AUTONOMOUS SUBSIDIARY ----- | RETAINED EARNINGS ----- |
|--|---------------------------|------------------------------|--|-------------------------------|
| NIS IN THOUSANDS | | | | |
| ----- | | | | |
| BALANCE - DECEMBER 31, 2002 | 8,263 | 132,127 | - | 216,209 |
| CHANGES DURING 2003: | | | | |
| Dividend paid | | | | |
| Exchange rate differences of prior year declared dividend | | | | |
| Net income for the year | 62,615 | 62,615 | | |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2003 | 8,263 | 132,127 | - | 277,853 |
| CHANGES DURING 2004: | | | | |
| Dividend paid | | | | |
| Distribution of bonus shares | 250 | 23,615 | | (23,865) |
| Translation adjustments relating to foreign held autonomous Subsidiary | | | (3,377) | |
| Net income for the year | | | | 36,642 |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2004 | 8,513 | 155,742 | (3,377) | 290,630 |
| CHANGES DURING 2005: | | | | |
| Dividend paid | | | | (43,619) |
| Translation adjustments relating to foreign held autonomous Subsidiary | | | 3,995 | |
| Net income for the year | | | | 42,409 |
| | ----- | ----- | ----- | ----- |
| BALANCE - DECEMBER 31, 2005 | 8,513 | 155,742 | 618 | 289,575 |
| | ===== | ===== | ===== | ===== |