

DELTA GALIL INDUSTRIES LTD  
Form 20-F  
March 30, 2007

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 30, 2007

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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

COMMISSION FILE NUMBER 000-30020

DELTA GALIL INDUSTRIES LTD.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

ISRAEL  
(Jurisdiction of incorporation or organization)

2 KAUFMAN STREET, TEL AVIV 68012, ISRAEL  
(Address of principal executive offices)

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

| TITLE OF CLASS                 | NAME OF EXCHANGE     |
|--------------------------------|----------------------|
| -----<br>Ordinary Shares (1)   | -----                |
| American Depositary Shares (2) | Nasdaq Global Market |

-----  
(1) Not for trading, but only in connection with the listing of the American Depositary Shares.

(2) Evidenced by American Depositary Receipts, each American Depositary Share representing one ordinary share, par value NIS 1.00 per share.

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

NONE

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

NONE

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

AS OF DECEMBER 31, 2006 THE REGISTRANT HAD 20,113,711 ORDINARY SHARES OUTSTANDING (INCLUDING 1,206,802 ORDINARY SHARES OWNED BY THE REGISTRANT AND 166,031 ORDINARY SHARES HELD BY A TRUSTEE IN CONNECTION WITH THE REGISTRANT'S STOCK OPTION PLANS).

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act 1934.

Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing

requirements for the past 90 days.

Yes  No

Indicate by check mark which financial statement item the Registrant elected to follow:

Item 17  Item 18

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer  Accelerated Filer  Non-Accelerated Filer

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### INTRODUCTION

As used herein, references to "we," "our," "us," "Delta Galil" or the "Company" are references to Delta Galil Industries Ltd. and to its consolidated subsidiaries, except as the context otherwise requires. In addition, references to our "financial statements" are to our consolidated financial statements except as the context otherwise requires.

In this document, references to "\$," "US\$," "U.S. dollars" and "dollars" are to United States dollars and references to "NIS" and "shekels" are to New Israeli Shekels.

Our financial statements included in this annual report are prepared in accordance with U.S. GAAP, and the accompanying discussion of the results of our operations is based on our results under U.S. GAAP. See "Item 18. Financial Statements" and "Item 5. Operating and Financial Review and Prospects-Operating Results".

Delta Galil had 20,113,711 ordinary shares outstanding as of March 25, 2007, including shares held by Delta Galil itself and shares held by a trustee in connection with Delta Galil's stock option plans. Percentages of outstanding shares used herein are based on 18,740,878 ordinary shares outstanding as of March 1, 2007, which excludes 1,206,802 ordinary shares held by Delta Galil, and 166,031 ordinary shares held by a trustee in connection with Delta Galil's stock option plans.

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### PART I

#### ITEM 1: IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

#### ITEM 2: OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

#### ITEM 3: KEY INFORMATION

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### 3.A SELECTED FINANCIAL DATA

The selected consolidated statement of income data set forth below have been derived from Delta Galil's audited consolidated financial statements, which were prepared in accordance with U.S. GAAP. The selected consolidated financial data set forth below should be read in conjunction with "Item 5. Operating and Financial Review and Prospects" and Delta Galil's consolidated financial statements and the notes to those financial statements included in Item 18 of this annual report.

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|  | YEAR ENDED DECEMBER 31 |           |           |      |
|--|------------------------|-----------|-----------|------|
|  | 2002                   | 2003      | 2004      |      |
| (\$ IN THOUSANDS, EXCEPT PER SHARE)                        |                        |           |           |      |
| STATEMENT OF INCOME DATA:                                  |                        |           |           |      |
| Net revenues .....   | \$567,298              | \$580,130 | \$654,269 | \$ 6 |
| Cost of revenues .....                                     | 454,238                | 463,863   | 533,036   | 5    |
| Gross profit .....   | 113,060                | 116,267   | 121,233   | 1    |
| Selling, marketing, general administrative expenses .....  | 84,135                 | 82,089    | 98,646    | 1    |
| Amortization of intangible asset .....                     |                        |           |           |      |
| Loss (gain) from realization of assets .....               | 92                     | (3,645)   | (922)     |      |
| Impairment of fixed assets .....                           |                        |           |           |      |
| Restructuring expenses .....                               | 1,065                  | 1,007     | 1,100     |      |
| Goodwill impairment .....                                  |                        |           |           |      |
| Operating income (loss) .....                              | 27,768                 | 36,816    | 22,409    | (    |
| Financial expenses - net .....                             | 5,456                  | 5,637     | 6,231     |      |
| Other income - net .....                                   | 960                    | 252       | 958       |      |
| Income (loss) before taxes on income .....                 | 23,272                 | 31,431    | 17,136    | (    |
| Income tax benefit (expense) .....                         | (5,779)                | (7,340)   | (2,846)   |      |
| Income (loss) after taxes on income .....                  | 17,493                 | 24,091    | 14,290    | (    |
| Share in profits (losses) of associated companies - net .. | 158                    | (300)     | (237)     |      |
| Minority interests - net .....                             | (1,025)                | (439)     | (1,368)   |      |
| Net income (loss) .....                                    | \$ 16,626              | \$ 23,352 | \$ 12,685 | \$ ( |
| EPS:   |                        |           |           |      |
| Basic .....  | \$ 0.88                | \$ 1.28   | \$ 0.69   | \$   |
| Diluted .....  | \$ 0.88                | \$ 1.24   | \$ 0.67   | \$   |
| Weighted average number of shares used in computation(1)   |                        |           |           |      |
| Basic .....  | 18,914                 | 18,313    | 18,478    |      |
| Diluted .....  | 18,927                 | 18,763    | 18,834    |      |
| Cash dividend per ordinary shares .....                    | \$ 0.37                | \$ 0.52   | \$ 0.45   |      |

(1) See note 11g of the notes to Delta Galil's consolidated financial statements included in Item 18 of this annual report for a discussion of

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the shares used to compute net income per share for the years ended December 31, 2004, 2005 and 2006.

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|                              | YEAR ENDED DECEMBER 31, |           |           |           |           |
|------------------------------|-------------------------|-----------|-----------|-----------|-----------|
|                              | 2002                    | 2003      | 2004      | 2005      | 2006      |
|                              | (\$ IN THOUSANDS)       |           |           |           |           |
| <b>BALANCE SHEET DATA:</b>   |                         |           |           |           |           |
| Cash and cash equivalents .. | \$ 14,491               | \$ 17,699 | \$ 22,150 | \$ 14,595 | \$ 10,342 |
| Working capital (1) .....    | 67,945                  | 56,612    | 127,382   | 80,949    | 54,853    |
| Total assets .....           | 441,058                 | 450,884   | 534,497   | 476,573   | 450,862   |
| Shareholders' equity .....   | 197,829                 | 212,334   | 221,081   | 184,314   | 188,217   |
| Amount of Share Capital .... | 21,792                  | 21,830    | 21,840    | 21,840    | 21,851    |

(1) Working capital is computed as total current assets less current liabilities.

### 3.B CAPITALIZATION AND INDEBTEDNESS -

Not applicable.

### 3.C REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

### 3.D RISK FACTORS

The following factors, in addition to other information contained in this annual report, should be considered carefully.

This annual report includes certain statements that are intended to be, and are hereby identified as, "forward-looking statements" for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties, and assumptions about Delta Galil, including, among other things:

- o our anticipated growth strategies;
- o our intention to introduce new products;
- o increased competition, especially from the Far East;
- o anticipated trends in our business;
- o future expenditures for capital projects; and
- o our ability to continue to control costs and maintain quality.

Forward-looking statements can be identified by the use of

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forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue" or other similar words. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other "forward-looking" information. When considering such forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this annual report.

These statements may be found in Item 4: "Information on the Company" and Item 5: "Operating and Financial Review and Prospects" and in this annual report generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Risk Factors" and elsewhere in this annual report.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur.

RECENT CHANGES IN WORLD TRADE ORGANIZATION QUOTAS COULD PUT PRESSURE ON APPAREL PRICES.

Effective January 1, 2005, the World Trade Organization's 148 member nations lifted some of the quotas on apparel and textiles. As a result, some of the textiles and textile apparel manufactured in a member nation are no longer subject to quota restrictions, although in 2006, some of the quotas on products from China were re-imposed. This change allows retailers, apparel firms and others to import unlimited quantities of apparel and textile items from China, India and other low-cost countries. As a result, prices of textiles and apparel, including our products, have faced downward pressure and may continue to decline. If

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prices decline faster than we are able to cut costs, our business and results of operations could be affected adversely.

MOST OF DELTA GALIL'S SALES ARE TO A FEW SIGNIFICANT CUSTOMERS. ANY REDUCTION OF PURCHASES BY ANY SIGNIFICANT CUSTOMER COULD MATERIALLY ADVERSELY AFFECT DELTA GALIL'S REVENUES.

A majority of Delta Galil's revenues is from sales to three customers. In 2006, 22% of Delta Galil's revenues were from sales to Marks and Spencer, Delta Galil's largest customer. Sales to Wal-Mart reached 21% of revenues and sales to Target reached 8% of revenues. Delta Galil's contracts with its customers, including Marks & Spencer, Wal-Mart and Target are short-term and do not contain minimum purchase requirements. It is possible that, in the future, Delta Galil's customers will not purchase Delta Galil's products in the same volumes or on the same terms as in the past. Any reduction of purchases by Marks & Spencer, Wal-Mart, Target or other key customers could adversely affect Delta Galil.

DELTA GALIL HAS BENEFITED FROM ITS SHIFT OF LABOR-INTENSIVE PRODUCTION TO LOWER LABOR COST COUNTRIES. A RISE IN WAGE LEVELS IN THOSE COUNTRIES COULD ADVERSELY AFFECT DELTA GALIL'S FINANCIAL RESULTS.

Delta Galil owns production facilities and outsources production in countries that have low labor costs. In 2006, Delta Galil produced goods in Jordan, Egypt, Turkey, Eastern Europe and the Far East that accounted for

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approximately 88% of its revenues. Historically, Delta Galil's operating results have benefited from this shift of labor-intensive production to lower labor cost countries, and Delta Galil intends to increase its production in low labor cost countries. Delta Galil's financial results could be harmed if wage levels increased dramatically in the countries in which Delta Galil produces. In addition, there can be no assurance that we will be able to shift additional production to lower labor cost countries.

A DETERIORATION IN ISRAEL'S RELATIONSHIP WITH NEIGHBORING COUNTRIES IN WHICH DELTA GALIL HAS PRODUCTION FACILITIES COULD INTERRUPT DELTA GALIL'S PRODUCTION AND HARM ITS FINANCIAL RESULTS.

Products produced in Egypt, Jordan and Turkey accounted for 35% of our 2006 revenues. Delta Galil's operations in these countries depend largely on their relationship with the State of Israel. In the past, there have been hostilities between Israel and Jordan and Egypt. In addition, since October 2000, there has been an increase in hostilities between Israel and the Palestinians. As a result, several Arab states reduced the level of relations with the State of Israel, principally regarding economic and commercial activities. A deterioration in Israel's relations with Jordan or Egypt could interrupt Delta Galil's foreign production operations and would adversely affect Delta Galil.

DUE TO SEASONAL FLUCTUATIONS, DELTA GALIL'S OPERATING RESULTS IN ANY QUARTER MAY NOT BE REPRESENTATIVE OF FUTURE PERFORMANCE.

Delta Galil has experienced fluctuations in its annual and quarterly operating results, and may continue to experience these fluctuations in the future. Delta Galil's revenues have fluctuated in certain years due to seasonal purchasing by consumers. Revenues in the last two quarters of certain years exceeded revenues in the first two quarters due to back-to-school and holiday purchases. Because of these fluctuations, Delta Galil's operating results in any quarter may not be representative of its future performance. These fluctuations may make it difficult for investors to properly evaluate Delta Galil's prospects.

DELTA GALIL'S INTERNATIONAL OPERATIONS EXPOSE IT TO THE RISK OF FLUCTUATIONS IN CURRENCY EXCHANGE RATES THAT COULD HARM ITS OPERATING RESULTS.

Although Delta Galil is an Israeli company, its functional currency is the U.S. dollar. Delta Galil has operations and sales in many countries that are not denominated in dollars, and is therefore exposed to fluctuations in the rate of exchange between the dollar and those currencies. In 2006, Delta Galil derived 24.3% of its revenues from customers in Pounds Sterling, 8.5% in NIS, and 7.6% in Euros. More than 10% of Delta Galil's expenses in 2006 were in NIS.

Some of Delta Galil's expenses in Israel are linked to the Israeli consumer price index. Consequently, Delta Galil is exposed to risk to the extent that the rate of Israeli inflation exceeds the rate of the NIS devaluation in relation to the U.S. dollar and to the extent that the timing of such devaluation lags behind inflation in Israel, resulting in a negative effect on Delta Galil's profitability in dollar terms in those periods.

In order to limit Delta Galil's exposure to fluctuations in the exchange rate between the U.S. dollar and other currencies, Delta Galil from time to time purchases forward contracts for the exchange of foreign currencies into dollars at a fixed rate. Nevertheless, these hedging transactions will not protect Delta Galil if the decline in those currencies against the dollar continues for longer than the term of the forward contracts. See Item 11: "Quantitative and Qualitative Disclosures About Market Risk".

INTEGRATION OF RECENT ACQUISITIONS WITH DELTA GALIL REQUIRES SUBSTANTIAL MANAGERIAL RESOURCES, AND DELTA GALIL MAY BE UNABLE TO ACHIEVE INTEGRATION SUCCESSFULLY.

In December 2004, Delta Galil acquired Burlen Corporation, and in November 2003 Delta Galil completed the acquisition of Auburn Hosiery Mills and its subsidiaries. We are continuing to integrate the facilities and personnel of these acquired companies. The integration diverts substantial attention of our senior management team from Delta Galil's daily operations, places significant pressure on our staff and other resources and poses financial, operational and legal risks. The integration may be impeded by general economic conditions, failure to integrate financial and operating systems, adverse response of competitors or clients, or regulatory developments. Any failure to complete the integration successfully could adversely affect Delta Galil.

THE APPAREL INDUSTRY IS SUBJECT TO CHANGES IN FASHION PREFERENCES. IF DELTA GALIL AND ITS CUSTOMERS MISJUDGE A FASHION TREND, SALES COULD DECLINE.

Delta Galil's success depends, in part, on its ability to design and manufacture products that will appeal to consumers' changing fashion preferences. Delta Galil may not be successful in anticipating and responding to fashion trends in the future. If Delta Galil and its customers misjudge a fashion trend, the customer's orders may decline, which could adversely affect Delta Galil.

DELTA GALIL MAY BE UNABLE TO COMPETE WITH OTHER MANUFACTURERS THAT HAVE FINANCIAL, GEOGRAPHIC AND OTHER ADVANTAGES.

Delta Galil competes directly with numerous manufacturers of apparel, which enjoy better economies of scale and/or lower effective labor costs, are closer geographically to customers and/or suppliers, and enjoy greater financial and marketing resources than Delta Galil. Increased competition could result in pricing pressure or loss of market share and adversely affect Delta Galil's revenues and profitability. There can be no assurance that Delta Galil will be able to compete successfully against existing or new competitors.

IF PRIVATE LABEL CUSTOMERS PRODUCE THEIR OWN PRODUCTS AND CONTRACT DIRECTLY WITH MANUFACTURERS SUCH AS DELTA GALIL, OUR SALES COULD DECLINE.

Recently, some large retailers have attempted to bypass private label underwear manufacturers and to contract directly with factories to produce their own products. This trend is most likely to occur in the more basic, mass-market products, in which design is less of a factor. If this trend continues and grows, it could have an adverse effect on Delta Galil's sales in those categories.

IF DELTA GALIL'S CUSTOMERS ARE UNABLE TO SUCCESSFULLY COMPETE IN THEIR MARKETS, DELTA GALIL'S REVENUES COULD DECLINE.

Delta Galil's customers operate in an intensely competitive retail environment. In the event that any of its customers' sales decline for any reason, whether or not related to Delta Galil or its products, Delta Galil's sales to such customers could also decline.

GMM CAPITAL AND DOV LAUTMAN OWN OVER 50% OF DELTA GALIL'S OUTSTANDING SHARES, AND TOGETHER CAN CONTROL DELTA GALIL'S MANAGEMENT.



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GMM Capital beneficially owns 5,323,793 ordinary shares, representing 28.4% of the outstanding ordinary shares of Delta Galil. Mr. Dov Lautman the Chairman of the Board of Directors of Delta Galil, beneficially owns 4,644,993 ordinary shares, representing approximately 24.8% of the ordinary shares outstanding. Mr. Lautman and the companies that he controls have a shareholders' agreement with GMM Capital that requires each party to vote the shares it beneficially owns to elect directors designated by GMM Capital to compose 30% of the board of directors, other than independent directors, and to elect Mr. Lautman's designees for the remainder of the board, other than independent directors. In addition, the agreement provides that the appointment of a new Chief Executive Officer requires the consent of GMM Capital, and the consent of both GMM Capital and the companies controlled by Mr. Lautman is required for a number of major decisions, as described in "Item 7 -- Major Shareholders And Related Party Transactions - Shareholders Agreements." Mr. Lautman and GMM Capital have also given one another the first opportunity to buy any shares the other party wishes to sell. Mr. Lautman and GMM Capital together have the power to elect all of the directors other than independent directors, appoint management and approve actions requiring the approval of a majority of Delta Galil's shareholders.

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DOV LAUTMAN, DELTA GALIL'S CHAIRMAN, FOUNDER AND ONE OF THE PRINCIPAL SHAREHOLDERS, HAS SIGNIFICANTLY CONTRIBUTED TO ITS SUCCESS. IF DOV LAUTMAN WERE TO LEAVE, DELTA GALIL COULD BE ADVERSELY AFFECTED.

Dov Lautman, the Chairman of the Board of Directors, a founder and one of the principal shareholders of Delta Galil, has made significant contributions to its growth. Delta Galil does not have an employment agreement with Mr. Lautman. Should Mr. Lautman discontinue his service, Delta Galil's business may be adversely affected.

DELTA GALIL HAS NO CONTROL OVER FLUCTUATIONS IN THE COST OF THE RAW MATERIALS IT USES OR THE COST OF FREIGHT. A RISE IN COSTS COULD HARM DELTA GALIL'S PROFITABILITY.

The primary raw materials used by Delta Galil in the manufacture of its products are cotton yarn, Lycra(R) and elastics. Delta Galil's financial performance is dependent to a substantial extent on the cost and availability of these raw materials. The price of these raw materials, as well as freight costs, fluctuate due to varying supply and demand and other market factors over which Delta Galil has no control. Delta Galil may not be able to transfer the increased costs due to a rise in prices of raw materials to its customers. This would likely adversely affect Delta Galil's profitability and financial condition.

BECAUSE DELTA GALIL OPERATES INTERNATIONALLY, IT IS EXPOSED TO CHANGES IN FOREIGN REGULATIONS, TARIFFS, TAX LAWS AND OTHER RISKS INHERENT TO INTERNATIONAL BUSINESS, ANY OF WHICH COULD AFFECT DELTA GALIL'S OPERATING RESULTS.

Delta Galil's international purchases, sales and production expose it to risks inherent in doing business in international markets such as:

- o adverse changes in foreign regulations, export restrictions, tariffs, trade barriers and tax rules;
- o difficulty in staffing and managing international operations; and
- o changes in social, political and economic conditions.

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Any of these factors could adversely affect Delta Galil's ability to deliver or receive goods on a competitive and timely basis and its results of operations.

DELTA GALIL HAS NO ESTABLISHED DIVIDEND POLICY AND CANNOT ASSURE THE AMOUNT OR FREQUENCY OF FUTURE DIVIDENDS.

Delta Galil does not have an established dividend policy. Delta Galil distributed cash dividends to shareholders from time to time in the past and may do so in the future. However, Delta Galil cannot assure the amount, frequency or any distribution of future dividends. Delta Galil's board of directors will determine future dividends, in light of several factors including Delta Galil's earnings, financial condition and capital requirements. In addition, under Israeli law, Delta Galil may pay dividends only out of accumulated earnings or out of net earnings for the two years preceding the distribution of the dividends.

A REVIVAL OF HOSTILITIES INVOLVING ISRAEL COULD ADVERSELY AFFECT DELTA GALIL'S INTERNATIONAL TRADE AND OPERATIONS.

Delta Galil is incorporated under the laws of the State of Israel, where it also maintains its headquarters and a significant part of its manufacturing facilities. Political, economic and military conditions in Israel directly influence Delta Galil. Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite progress towards peace between Israel, its Arab neighbors and the Palestinians, major hostilities may revive. Such hostilities may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on Delta Galil's operations and business.

Generally, male adult citizens and permanent residents of Israel are obligated to perform military reserve duty annually. Additionally, these residents may be called to active duty at any time under emergency circumstances. The full impact on Delta Galil's workforce or business if some of Delta Galil's officers and employees are called upon to perform military service is difficult to predict.

DELTA GALIL BENEFITS FROM ISRAELI GOVERNMENT PROGRAMS THAT COULD BE REDUCED OR ELIMINATED, INCREASING DELTA GALIL'S COSTS.

Many of Delta Galil's existing production facilities in Israel were entitled to Israeli government grants and tax benefits. Delta Galil received grants until 2004 under these programs. The grant levels have been reduced in the past by the Israeli government and there can be no assurance that the Israeli government

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will not further reduce these investment grants. See Item 10: "Additional Information - Israeli Taxation."

Due to existing losses for tax purposes, Delta Galil has not used any of the tax benefits to which it is entitled under these government programs since 1999, except with respect to accelerated depreciation on real-estate property. The remaining tax benefits may be available for use in future years. See Item 10: "Additional Information - Israeli Taxation."

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The termination or reduction of these Israeli government programs, particularly benefits available to Delta Galil as a result of the "Approved Enterprise" status of its existing facilities, would increase Delta Galil's costs of acquiring machinery and equipment for its production facilities, which could have an adverse effect on Delta Galil.

In order to maintain eligibility for these grants and tax benefits, Delta Galil must continue to meet various conditions, such as investment in fixed assets and operations in specified zones. If Delta Galil fails to meet these conditions in the future, it could be required to forego tax benefits and to refund grants already received, in whole or in part, with interest, linked to the consumer price index in Israel. To secure its obligations, Delta Galil gave the Israeli government a security interest over all its assets in Israel.

DELTA GALIL BENEFITS FROM PRODUCING IN COUNTRIES THAT HAVE FREE TRADE AGREEMENTS WITH COUNTRIES WHERE ITS CUSTOMERS ARE LOCATED. A LOSS OF THESE FREE TRADE ADVANTAGES WOULD ELIMINATE AN IMPORTANT COMPETITIVE ADVANTAGE.

Delta Galil benefits from Israel's free trade agreements with the United States, Canada, the European Union and the European Free Trade Association. The trade agreements permit Delta Galil to sell its Israeli manufactured products to the United States, Canada, and the member countries of the European Union and the European Free Trade Association free of customs duties and import quotas. The United States has extended the benefits of the Israel- United States Free Trade Area Agreement to goods processed in the area of Jordan in which Delta Galil has its facilities. Due to a free trade agreement between the European Union, the United States and Egypt, Delta Galil's products manufactured in Egypt can enter the EU countries and into the United States, free of duties and quotes, as well. A loss of these free trade advantages would eliminate an important competitive advantage.

YOU MAY NOT BE ABLE TO ENFORCE CIVIL LIABILITIES IN THE UNITED STATES AGAINST DELTA GALIL'S OFFICERS AND MOST OF ITS DIRECTORS.

Most of Delta Galil's officers and directors reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of Delta Galil's assets are located outside the United States, any judgment obtained in the United States against Delta Galil or any of its directors and officers may not be collectible within the United States.

### ITEM 4: INFORMATION ON THE COMPANY

#### 4.A HISTORY AND DEVELOPMENT OF THE COMPANY

Delta Galil Industries Ltd. was incorporated in Israel in 1975 and operates as a public company with liability limited by shares under the Israeli Companies Law, 1999. Our registered offices are located at 2 Kaufman Street, Tel-Aviv 68012, Israel and our telephone number is (972) 3-519-3636. Delta Galil's ordinary shares have been listed on the Tel Aviv Stock Exchange since 1982. In 1999 the trading of Delta Galil's ADSs commenced on the Nasdaq National Market, currently named the Nasdaq Global Market. Delta Galil, with its consolidated subsidiaries, is a global manufacturer and marketer of quality private label ladies' intimate apparel, men's underwear, socks, shirts, babywear, bras, leisurewear and nightwear, knitted fabrics, dyeing, trimmings and elastic ribbons. Delta Galil sells its products to leading retailers, including:

- o Marks & Spencer (U.K.)
- o Wal-Mart (U.S.)
- o Target (U.S.)

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- o Victoria's Secret (U.S.)
- o Hema (Holland)
- o JC Penney (U.S.)
- o Kmart (U.S.)
- o Mervyn's (U.S.)

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and to marketers of leading brand names, including:

- o Calvin Klein (U.S.)
- o Nike
- o Hugo Boss (Germany)
- o Pierre Cardin

Delta Galil also sells its products under brand names which are licensed to Delta Galil, such as Wilson(R), Barbie(R), Maidenform(R), Nicole Miller(R), as well as under the Delta brand name (in Israel).

Delta Galil's ability to provide its customers with a comprehensive package of services has enabled it to develop and maintain strong long-term relationships with its customers. These services include:

- o product line planning and design;
- o manufacture of high quality knitted apparel using automated manufacturing processes; and
- o marketing, packaging and distribution of finished products tailored to the requirements of the customers in Europe and the United States.

Delta Galil designs and develops its products primarily in the United States, England and Israel. Most of Delta Galil's products are manufactured in lower labor cost countries, such as Egypt, Jordan and Turkey as well as countries in the Far East.

### CAPITAL EXPENDITURES

The following table shows Delta Galil's fixed assets purchases in thousands US dollars for the last three years on a cash flow basis, broken down by regions. These capital expenditures were financed from Delta Galil's operating cash flow.

|                   | YEAR ENDED DECEMBER 31, |          |         |
|-------------------|-------------------------|----------|---------|
|                   | 2004                    | 2005     | 2006    |
|                   | -----                   | -----    | -----   |
| Israel .....      | \$ 6,602                | \$ 3,424 | \$2,364 |
| China .....       |                         | 3,665    | 855     |
| Egypt .....       | 3,253                   | 3,100    | 619     |
| North America ... | 851                     | 2,233    | 790     |
| Thailand .....    |                         |          | 501     |
| India .....       |                         |          | 340     |
| United Kingdom .. | 314                     | 209      | 70      |
| Eastern Europe .. | 1,112                   | 109      | 16      |
| Jordan .....      | 914                     | 38       | 83      |
| Others .....      | 438                     | 256      | 68      |
|                   | -----                   | -----    | -----   |
| Total             | \$13,484                | \$13,034 | \$5,706 |

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### 4.B BUSINESS OVERVIEW

#### COMPETITIVE STRENGTHS

The apparel market is highly competitive and fragmented. Delta Galil's products compete with the products of other manufacturers located throughout the world.

Competition in the apparel market is generally based on price, quality and customer service. Delta Galil believes that it has a relative advantage over its competitors for the following reasons:

- o HIGH QUALITY INNOVATIVE PRODUCT LINES. Delta Galil produces a broad selection of fashionably designed product lines using high quality knitted materials and attractive packaging. In 1998, Delta Galil introduced seamless intimate apparel, known as "seam-free" products. These products are produced using techniques that minimize labor-intensive production functions. In 2005 Delta introduced the next generation cotton "Real Cool Cotton" (RCC). RCC(TM) uses a nano-technology process along with special treatment to increase the absorption capacity of the fabric, simultaneously transferring moisture to the surface and enabling swift evaporation.
- o LONG-TERM RELATIONSHIPS WITH LEADING RETAILERS AND BRAND NAME MARKETERS. Delta Galil has developed long-term relationships with its customers, many of whom control significant market shares in their respective countries. Although Delta Galil's customer contracts are generally short-term and do not contain minimum purchase requirements, Delta Galil has enjoyed relationships of more than five years with most of its major customers. Delta Galil and its in-house design teams and technology experts work closely with customers to provide a comprehensive package of services, including design, development, manufacturing and marketing of new product lines.

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- o UNIQUE FREE TRADE STATUS. Israel has free trade agreements with each of the United States, Canada, the European Union and the European Free Trade Association. Delta Galil's operations in Jordan and Egypt also benefit from advantageous trade agreements.

#### STRATEGY

The key elements of Delta Galil's strategy are to:

- o ENHANCE SALES TO EXISTING LARGE CUSTOMERS. Delta Galil seeks to increase sales of existing products and to introduce new product categories to existing customers. Delta Galil believes its broad product offerings, emphasis on customer service and proven reliability provide a competitive advantage as retailers consolidate purchases from a smaller number of suppliers. Delta Galil intends to continue capitalizing on this trend by expanding the scope of its existing customer relationships.
- o DEVELOP RELATIONSHIPS WITH SELECTED NEW CUSTOMERS. Delta Galil is

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developing relationships with new customers who require high quality products to sell under their private labels or brands, are capable of ordering in significant volumes, demonstrate substantial growth potential and require Delta Galil's high level of service. Recent customer additions include Tommy Hilfiger(R), Puma(R), Polo(R), and Carrefour(R) (Europe), and Nicole Miller(R) (North America).

- o CONTINUOUSLY IMPROVE ITS MANUFACTURING EFFICIENCY. Delta Galil continuously seeks to increase manufacturing efficiencies by (1) moving labor intensive functions to lower cost countries, (2) further automating its operations and (3) introducing new technologies.
- o PURSUE STRATEGIC ACQUISITIONS. In December 2004 Delta acquired Burlen Corporation. Delta Galil may pursue additional strategic acquisitions of businesses that would complement its product lines and customer relationships.
- o BRANDING. The market positioning of brands is becoming more prominent. Behind each such brand there is a message, which brings the consumer, an emotional attachment to the product. Delta Galil, traditionally a private label manufacturer, began licensing leading brand names in the last few years for use in socks and men's and ladies' underwear. These brands include, Nicole Miller(R) worldwide; Wilson(R) and Converse(R) for socks and men's and ladies' underwear for the European and North American market; Barbie(R) for girls' sleepwear in the United States and Maidenform(R) for girls' bras in the United States. Delta handles all aspects of production from the initial processes to finished products and inventory management. Delta Galil is looking for additional brands to license.

### 2004 ACQUISITION

#### ACQUISITION OF BURLLEN

In December 2004, Delta Galil acquired Burlen Corp., a leading private label manufacturer of ladies intimate apparel. Burlen's customers are mass and mid-market retailers. Burlen has been supplying Wal-Mart, its largest customer, for nearly 40 years. Burlen's design, merchandising and marketing teams are located in New York and its logistics, operations and distribution facilities are located in Tifton, Georgia. Burlen manufactures primarily through subcontractors in the Far East and the Caribbean.

Delta paid Burlen's selling shareholders \$48.2 million in cash and \$2.2 million in ordinary shares comprised of 215,684 ordinary shares valued at \$10.43 per share transferred from Delta's treasury shares. In addition, Delta paid \$8.2 million of Burlen's bank debt. Delta Galil also accrued \$1.0 million in other cost related to the transaction, which were paid in 2005.

During 2005, Delta Galil made a \$1.3 million additional payment to the selling shareholders with respect to additional costs incurred by the Company as it was agreed in the purchase agreement. This payment was recorded as additional goodwill.

In addition, under the agreement Delta Galil was required to pay additional amounts of up to \$15 million in the aggregate to the selling shareholders, subject to achieving certain revenues and operating profit targets over a period of three years, from 2005 to 2007.

In February 2006, the parties signed an amendment to the stock purchase agreement based on which the aggregate additional amount which could be paid to the selling shareholders was increased to a maximum of \$18 million, subject to achieving adjusted targets over a period of six years, from 2006 to

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2011. On March

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15, 2006, a non-refundable payment of \$1.3 million was made against future consideration with respect to 2007 and 2008 targets. In March 2007, Delta Galil made an additional \$2.4 million payment to the selling shareholders with respect to 2006 targets, as agreed in the purchase agreement. This payment was recorded on December 31, 2006 as additional goodwill.

PRODUCTS

Delta Galil works closely with its customers to design and manufacture high quality knitwear. Delta Galil produces a variety of products using cotton and man-made fibers, which are generally sold at all price levels.

The following table outlines representative products in each of Delta Galil's product categories, key customers/brands and the percentage of total revenues that each product category represented during 2004, 2005 and 2006.

| PRODUCT CATEGORY         | KEY PRODUCTS  | KEY CUSTOMERS/BRANDS  | % OF REVENUE        |      |
|--------------------------|---|---|---------------------|------|
|                          |   |   | YEAR ENDED DECEMBER | 2004 |
| Ladies' Intimate Apparel | Fashion and basic panties and bras<br>Women's nightwear<br>Girl's nightwear | Marks & Spencer<br>Wal-Mart<br>Target<br>JC Penney<br>Victoria's Secret<br>Calvin Klein | 54%                 | 61%  |
| Socks                    | Men's, women's and children's leisure, dress and sport socks                | Marks & Spencer<br>Nike<br>Wal-Mart<br>Hema   | 23%                 | 20%  |
| Men's Underwear          | Briefs<br>Boxer shorts<br>Mini-briefs<br>Undershirts<br>Men's nightwear     | Calvin Klein<br>Hema<br>Hugo Boss<br>Marks & Spencer<br>Wal-Mart<br>Target              | 13%                 | 11%  |
| Leisurewear              | T-shirts<br>Polo shirts<br>Sweatshirts<br>Leisure clothes                   | Marks & Spencer   | 4%                  | 3%   |
| Babywear                 | Fashion and classic items, focusing on newborns                             | Marks & Spencer   | 4%                  | 3%   |
| Others                   | Fabrics, elastic tapes and other operations                                 |   | 2%                  | 2%   |
|                          |   |   | ---                 | ---  |

- o LADIES' INTIMATE APPAREL: Delta Galil's intimate apparel items include both fashion and basic underwear, bras and seam-free panties, tops and control underwear. The decrease in this category as a percentage of total revenues in 2006 is mainly due to the decrease in sales to Marks & Spencer due to increased competition from the Far East.
- o SOCKS: Delta Galil manufactures men's, women's and children's socks in the leisure, dress and sports categories. Among the varieties of socks that Delta Galil manufactures are socks with popular cartoon and other characters that Delta Galil licenses. The decrease in this category in 2006 is mainly due to the decrease in sales in North America due to Delta's decision to cease its activity in Canada.

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- o MEN'S UNDERWEAR: Delta Galil manufactures men's fashion and basic underwear for customers that include marketers of fashion brands and department store private labels. The increased sales in this category in 2006 are attributed to a general increase in orders from most of our customers and due to the introduction of new Real Cool Cotton products.
- o LEISUREWEAR: Delta Galil manufactures basic and fashion leisurewear in a wide variety of styles and fabrics. The products range from T-shirts, polo shirts, sweatshirts and jogging suits to leisure and fashionable blouson jackets.
- o BABYWEAR: Babywear includes fashion and classic daywear and sleepsuits in a wide variety of styles and fabrics, with a focus on newborns.

#### CUSTOMERS

Delta Galil maintains long-term relationships with its customers, many of whom control significant market shares in their respective countries. Delta Galil premises its marketing strategy on its ability to offer customers a package of services, including product planning and design tailored to the customers' needs, high-tech quality manufacturing, distribution and logistics setup and computer-linked accounts.

Delta Galil has strong in-house creative teams of designers and technology experts, consisting of fashion designers, textile designers, yarn experts, knitting experts and dyeing and finishing experts. Delta Galil's design specialists remain constantly apprised of technological innovations in textile equipment and the state of the art in yarns, fabrics and accessories worldwide. Delta Galil's presence in both the United States and Europe also enables its design personnel to offer significant sales and marketing advice in both markets. Although Delta Galil's products are sold predominantly under the private labels and brands of its customers, Delta Galil's design specialists collaborate closely with its customers to design and develop products. The design teams prepare presentations for customers, including analysis of previous season successes and failures, and, with the customer's participation, develop the concept, product, packaging and product specifications, tailored to the customer's specific needs. Delta Galil believes that the comprehensive nature of the services it offers is a major factor in the strength of its relationship with its customers.



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### THE NORTH AMERICAN MARKET

Recognizing the North American market's size and diversification, Delta Galil targeted this market as its major strategic market for growth and profitability. Through internal growth and a series of acquisitions, Delta Galil has been successful in rapidly increasing its presence in the North American market. Sales to North America grew from \$47.3 million (which represented 16% of total sales) in 1998 to \$418.0 million (which represented 59% of total sales) in 2006. Our five largest customers in North America, Wal-Mart, Target, Victoria's Secret, JC Penney and Calvin Klein, represented approximately 79% of our 2006 sales in North America. The increase in 2006 sales in North American is mainly due to the increase in sales of ladies fashionable intimate apparel products to Victoria's Secret.

### MARKS & SPENCER RELATIONSHIP

Delta Galil is one of Marks & Spencer's five largest suppliers and has been doing business with Marks & Spencer for more than 20 years. Marks & Spencer sells all of its products under its own brand name and is one of the leading retailers of men's underwear, women's underwear and men's socks in the United Kingdom. Delta Galil is a diversified supplier to Marks & Spencer, selling to 12 different departments of the chain. Each department is independently managed, has autonomy in procurement decisions, and establishes its own product standards and supply requirements.

Delta Galil's sales to Marks & Spencer grew from \$1 million in 1981 to \$49 million in 1990, to \$92 million in 1995 and to \$156 million in 2006, representing 22% of Delta Galil's revenues in 2006. In 2006 sales to Marks & Spencer decreased by 3% compared to 2005 mainly in the ladies category due to the increased competition from the Far East which led to erosion in selling prices and to loss of sales.

### ISRAELI MARKET

Delta Galil believes that it is among the market leaders in Israel for men's underwear, ladies' intimate apparel and socks, with \$54.3 million of sales in 2006. These sales include products Delta Galil manufactures, as well as goods it imports into Israel or purchases from other Israeli suppliers. Of Delta Galil's sales in Israel, 42% were made through retail department stores and supermarkets, and 58% were made through Delta Galil's Delta Plus chain stores. As of December 31, 2006 Delta Plus had 86 stores.

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### SEASONALITY

Delta Galil's revenues fluctuate due to seasonal purchasing by consumers. Revenues in the last two quarters of certain years exceeded revenues in the first two quarters due to back-to-school and holiday purchases.

### MANUFACTURING

#### MANUFACTURING PROCESS

Delta Galil's manufacturing techniques enable it to provide its customers with a wide array of consistently high quality products customized to their individual needs at competitive prices. The production process includes

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the following steps:

- o **RAW MATERIAL PROCUREMENT:** The raw materials Delta Galil requires include, primarily, cotton yarns, blends of cotton and synthetic yarns (such as cotton-spandex, cotton-Lycra(R) and cotton-viscose) and other accessories such as elastic tapes, laces and other textile components. Delta Galil purchases its raw materials from several international and domestic suppliers and historically has not experienced any difficulty in obtaining raw materials to meet production requirements. The price of these raw materials fluctuates due to varying supply and demand and other market factors over which Delta Galil has no control. Delta Galil purchases its raw materials only against actual orders, except for basic cotton yarn. As a result, Delta Galil can effectively manage its raw material inventory. Typically, Delta Galil does not maintain inventory of raw materials for a period of more than eight weeks. From time to time, when market conditions are favorable, Delta Galil enters into contracts with various suppliers of basic cotton yarn for delivery over a period of three to six months.
  
- o **KNITTING:** Delta Galil produces the knitted fabric required for the underwear and other garments it manufactures in Israel and in Egypt. Delta Galil produces various types of fabric. Delta Galil operates approximately 160 automatic knitting machines, with a total production capacity of approximately 600 tons of fabric per month depending on the type of fabric produced. During 2006, Delta Galil produced approximately 410 tons of fabric per month, approximately 91% of which Delta Galil used and the remainder was sold to third parties. Delta Galil does not have any long-term supply obligations and is able to adjust its capacity for its own use when necessary. Delta Galil outsources from various suppliers the rest of the knitted fabric it requires.  
  
Delta Galil operates approximately 2,000 knitting machines for the production of socks, including machines owned by sub-contractors, with a total production capacity of approximately 12 million pairs per month.
  
- o **DYEING AND FINISHING:** Delta Galil has its own dyeing plant in Israel for fabrics and products. The dyeing plant is principally engaged in supplying Delta Galil's own requirements. Delta Galil outsources the dyeing and finishing for production in Egypt. Delta Galil's ability to control the dyeing and finishing of its products and accumulated expertise in this area are key elements in its ability to provide quality products to its customers.
  
- o **CUTTING:** Delta Galil uses computerized, automatic cutting equipment, which minimizes fabric waste.
  
- o **SEWING:** Cut fabrics are sewn to complete the product, including the addition of accessories such as elastic waist and leg bands and labels. Delta Galil is currently operating at its sewing capacity, which is, on an average basis, approximately 6 million units per month (depending on the type of product). Delta Galil operates its sewing plants, in Jordan, Egypt and the Far East. Delta Galil also subcontracts sewing functions, primarily to contractors in Israel, Egypt, the Far East and Central America.
  
- o **TESTING AND QUALITY ASSURANCE:** Delta Galil places significant emphasis on quality control and uses quality assurance teams at each stage of the manufacturing process. Delta Galil's quality

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assurance procedures meet the very strict quality control standards of its customers.

### SEAM-LESS MANUFACTURING

Applying technology utilized in the manufacture of hosiery, Delta Galil produces one-piece seam-less panties and bras. Seam-less technology enables the direct conversion of yarn into a nearly completed final product by a single machine. After the machine knits the basic garment, all that is required to complete the garment is dyeing and a limited amount of sewing and finishing.

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The seam-less process eliminates most stages of the manufacturing process, which required special equipment such as knitting machines, cutting equipment and extensive sewing machine operations, and personnel. This advanced computer-intensive technology enables the production of a substantially wider range of fabrics, styles and product lines. The use of the seam-less machines also improves Delta Galil's potential to manufacture fashionable products with consistently higher quality, durability and comfort.

Delta Galil is making a major effort to capitalize on this unique technology. Delta Galil continuously engages in research and development to create additional products that use the seam-less technology. Sales of seam-less products decreased from \$40.2 million in 2000 to \$25.7 million in 2006. In 2006 sales increased by 7%, compared to \$24.0 million in 2005. As of December 31, 2006, Delta Galil owned 270 seam-less knitting machines.

### OUTSOURCING OF PRODUCTS

Subcontractors manufactured goods in Egypt (babywear and underwear), Turkey (socks), Bulgaria (socks), Thailand, Hong Kong, Vietnam, India, Bangladesh, Dominican Republic and China (all ladies intimate apparel), which in 2006 accounted for approximately 70% of Delta Galil's revenues. Delta Galil personnel closely supervise the production by subcontractors in these countries.

### JORDANIAN JOINT VENTURE

Since 1995, Delta Galil has maintained a joint venture with Century Investment Group, a Jordanian company. Delta Galil supplies cut fabric to the joint venture and purchases sewing services. Delta Galil holds a controlling interest in this joint venture and purchases virtually all of the goods produced by the joint venture. As a result of the controlling interest, Delta Galil consolidates this entity in its consolidated financial statements.

### SALES AND MARKETING

Delta Galil customizes its sales and marketing strategy according to individual customers' geographic regions and the market segment. For example, one sales and marketing group handles the Marks & Spencer account, another handles sales to the U.S. mass market, and a third focuses on accounts for middle and upper market customers in the United States. Depending on where a target customer is located, Delta Galil's sales offices in Europe, North America or Israel implement the marketing strategy in coordination with headquarters. Delta Galil staffs sales offices with experienced personnel who maintain ongoing contact with its customers and respond to customers' needs promptly and effectively.

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### MANAGEMENT INFORMATION SYSTEMS

Delta Galil has invested in information technology as a tool to reduce overall costs, improve internal controls, enhance the efficiency of its garment design and manufacturing, and support the sale and distribution of its products to its customers. Delta Galil's production software processes customer orders, schedules production for such orders and monitors the products ordered during all stages of production, from knitting to sewing and during packaging and distribution. Delta Galil believes that its information technology system has been effective in meeting its demands. Delta Galil spent approximately \$6.5 million in 2006 and intends to spend approximately \$8 million in 2007 to improve its system's capabilities.

### CONDITIONS IN ISRAEL

Delta Galil is incorporated under the laws of, and a significant portion of its offices and manufacturing facilities are located in, the State of Israel. Accordingly, Delta Galil is directly affected by political, economic and military conditions in Israel. The operations of Delta Galil would be materially adversely affected if major hostilities involving Israel should occur or if trade between Israel and its present trading partners should be curtailed.

### POLITICAL CONDITIONS

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. However, a peace agreement between Israel and Egypt was signed in 1979, a peace agreement between Israel and Jordan was signed in 1994 and, since 1993, several agreements between Israel and Palestinian representatives have been signed. As of the date hereof, Israel has not entered into any peace agreement with Syria or Lebanon. There can be no assurance as to how the "peace process" will develop or what effect it may have upon Delta Galil.

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Despite progress towards peace between Israel, its Arab neighbors and the Palestinians, major hostilities may revive. Since October 2000, there has been an increase in hostilities between Israel and the Palestinians. In July 2006, a conflict with "Hezbollah" escalated significantly on Israel's northern border with Lebanon. The unrest in and around the areas administrated by the Palestinian Authority and on Israel's northern border may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on Delta Galil's operations and business. In addition, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. Delta Galil does not believe that the recent violence or the boycott have had a material adverse effect on Delta Galil, but there can be no assurance that further violence or restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on Delta Galil's business.

### TRADE AGREEMENTS

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade

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Organization and is a signatory to the General Agreement on Trade in Services and to the Agreement on Basic Telecommunications Services. In addition, Israel has been granted preferences under the Generalized System of Preferences from, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Delta Galil benefits from Israel's free trade agreements with the United States, Canada, the European Union and the European Free Trade Association as well as the QIZ Free Trade Agreements between the US, Israel, Jordan & Egypt. The trade agreements enable Delta Galil to sell its products to the above mentioned countries duty & quota free. Delta Galil is in a period of major changes in the global business environment, following the elimination of quotas as part of the WTO agreement which resulted in strong pressure to lower prices and widen the competition and supply.

### 4.C DELTA GALIL'S ORGANIZATIONAL STRUCTURE

Delta Galil is an Israeli corporation that commenced operations in 1975. It currently has thirty-four subsidiaries in which it holds at least a 50% interest. The main operations are included in the following companies:

| COMPANY                                | PLACE OF INCORPORATION | OWNERSHIP INTEREST | FUNCTION   |
|--|------------------------|--------------------|--|
| Delta Galil USA Inc.                   | Delaware, U.S.A.       | 100%               | Design, development and and girls intimate apparel |
| Burlen Corp.                           | Georgia, USA           | 100%               | Design, development and intimate apparel.          |
| Auburn Hosiery Mills Inc.              | Kentucky, USA          | 100%               | Design, development and                            |
| Delta Textile (New York) Ltd.          | New York, U.S.A.       | 100%               | Marketing  |
| Delta Galil Europe Ltd.                | U.K.                   | 100%               | Distribution center and                            |
| Delta Galil Holland B.V.               | Holland                | 100%               | Contract manufacture and                           |
| Delta Textile Egypt - Free Zone S.A.E. | Egypt                  | 100%               | Manufactures men's and w leisurewear.              |
| Century Wear Corporation (WLL)         | Jordan                 | 50% (*)            | Joint venture that perform services.               |
| Thai Progress Garment Co. Ltd          | Thailand               | 100%               | Manufactures ladies intim                          |
| Delta Textile Marketing Ltd.           | Israel                 | 100%               | Retail and wholesale in                            |
| Delta Elastic Tapes Industries, Ltd.   | Israel                 | 90%                | Manufactures elastic tap components used in under  |

(\*) Delta Galil effectively controls this joint venture as a result of its holding of an additional controlling share.

### 4.D PROPERTY, PLANT AND EQUIPMENT

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Delta Galil has manufacturing facilities in Israel, Jordan, Egypt, Bulgaria, Thailand and India. Delta Galil has also sub-contracts with manufacturers in Egypt, Turkey, Bulgaria, Central America and the Far East. In 1995, Delta Galil began transferring labor-intensive production functions from its plants in Israel and Scotland to Egypt, Jordan, Eastern Europe and the Far East. As a result all manufacturing plants in Scotland were closed by 2003 and the last sewing plant in Israel was closed in 2005. In 2006, Delta Galil closed its production facilities in Honduras and Canada as part of the restructuring plan initiated in 2005. In 2006, 88% of Delta Galil's revenues were generated from the sale of products produced in low labor cost countries, up from 49% in 2000. In 2006, goods produced in Israel represented 8% of Delta Galil's revenues, down from 35% in 2000.

The following table summarizes the distribution of Delta Galil's revenues by location of production, stated as a percentage of total revenues for the periods indicated:

| COUNTRY                     | ACTIVITY   | PRODUCTS  | YEAR |
|-----------------------------|--|---|------|
| Far East                    | Purchase of finished products<br>Sewing<br>Cutting   | Ladies intimate apparel<br>Leisurewear<br>Men's underwear                               | 2006 |
| Egypt                       | Knitting(2)<br>Dyeing(1)<br>Cutting<br>Sewing(2)<br>Purchase of finished products  | Ladies' intimate apparel<br>Men's underwear<br>Babywear<br>Leisurewear                  | 2006 |
| Jordan                      | Sewing(2) (3) (4)  | Ladies' intimate apparel<br>Men's underwear   | 2006 |
| Israel                      | Design & Development<br>Knitting(2)<br>Dyeing<br>Cutting & sewing(2)<br>Production of fabrics & elastics<br>Distribution center<br>Purchase of finished products | Ladies' intimate apparel<br>Men's underwear<br>Socks<br>Knitted fabric<br>Elastic bands | 2006 |
| Caribbean & Central America | Sewing(2)<br>Cutting<br>Knitting(1)<br>Purchase of finished products   | Ladies' intimate apparel<br>Socks   | 2006 |
| Turkey                      | Purchase of finished products  | Socks   | 2006 |
| Eastern Europe              | Knitting(1)<br>Purchase of finished products   | Socks   | 2006 |
| North America               | Purchase of finished products  | Socks   | 2006 |

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- (1) These activities are fully outsourced to local contractors.
- (2) A portion of these activities is outsourced to local contractors.
- (3) This activity is performed by a joint venture in which Delta Galil has a controlling interest.
- (4) Fabric produced in Israel.

In Israel, Delta Galil owns six facilities, including its principal production facility in Karmiel, and leases eight facilities. The leases, including all extension options, for seven facilities expire on various dates between 2008 and 2015. One lease expires in 2007. Delta Galil is confident that it can renew such lease on terms no less favorable than the existing lease. In addition, Delta Galil leases a warehouse and development center outside London and leases offices in London. Delta Galil leases manufacturing and storage facilities in Egypt pursuant to 25-year leases that expire between 2014 and 2029. Delta Galil's joint venture in Jordan leases sewing facilities in Irbid, and in Amman.

Delta Galil leases warehouses and offices in Pennsylvania, New Jersey, Hong Kong, China and India. These leases expire between 2007 and 2014. Delta Galil is confident that it can renew these leases on terms no less favorable than existing leases. Delta Galil also owns other facilities in Bulgaria, Kentucky USA and Thailand. Management believes that Delta Galil's existing facilities are well maintained, in good operating condition and provide adequate space for Delta Galil's current level of operations. In addition, Delta Galil believes that its facilities and operations are in compliance with current governmental regulations regarding safety, health and environmental pollution. Delta Galil generally has complied with these regulations and such compliance has not had a material adverse effect on its capital expenditures, earnings or competitive position.

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During 2006 the Company sold its assets which were held for sale in Ireland, Scotland and part of its assets in the US for a total consideration of \$3.1 million.

On December 31, 2006 Delta Galil's unused real estate assets which are held for sale and include real-estate in Israel, Hungary and the United States, were classified as current assets at their net book value of \$4.5 million. In January 2007 Delta Galil sold its asset which was held for sale in the United States.

The following table shows Delta Galil's main owned and leased properties and facilities as of March 25, 2007:

| PLANT LOCATION                  | SQUARE FEET | MAIN FUNCTION                                  |
|---------------------------------|-------------|--|
| Karmiel, Israel                 | 534,000     | Textile manufacturing                          |
| Nahariya, Israel                | 2,750,000   | Undeveloped beach front property held for sale |
| Rosh Ha'ain, Israel             | 75,000      | Offices and warehouse                          |
| Delta Plus retail chain, Israel | 127,000     | Retail   |
| Yodfat, Israel                  | 42,000      | Warehouse and office                           |

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|                                 |         |  |
|---------------------------------|---------|--|
| Daliat El Carmel, Israel        | 35,500  | Elastic tape manufacturing                       |
| Tel Aviv, Israel                | 10,750  | Main office                                      |
| London, U.K.                    | 25,000  | Offices  |
| Northampton, and Mansfield U.K. | 122,000 | Warehouse and development center                 |
| Jordan                          | 343,000 | Sewing and warehouse                             |
| Egypt                           | 415,000 | Knitting, cutting, sewing, warehouse and offices |
| New Jersey, U.S.                | 37,000  | Offices  |
| New York, U.S.                  | 37,000  | Offices  |
| Pennsylvania, U.S.              | 350,000 | Warehouse, logistic center and offices           |
| Kentucky, U.S.                  | 250,000 | Offices & warehouse                              |
| Georgia, U.S.                   | 495,000 | Logistic center, warehouse and offices           |
| Hong Kong                       | 12,000  | Offices and warehouse                            |
| Hungary                         | 129,000 | Unoccupied Logistic center held for sale         |
| Bulgaria                        | 95,000  | Socks manufacturing                              |
| Thailand                        | 30,000  | Cutting and sewing                               |
| Guangzhou, China                | 157,000 | Offices  |
| India                           | 76,000  | Socks manufacturing                              |

### ITEM 4A: UNRESOLVED STAFF COMMENTS.

Not applicable.

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

THE FOLLOWING DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH DELTA GALIL'S CONSOLIDATED FINANCIAL STATEMENTS AND THE NOTES TO THOSE FINANCIAL STATEMENTS INCLUDED IN ITEM 18 OF THIS ANNUAL REPORT. DELTA GALIL'S CONSOLIDATED FINANCIAL STATEMENTS ARE PREPARED IN CONFORMITY WITH US GAAP.

#### OVERVIEW

Following is a discussion of certain topics that will help you better understand our results of operations discussed below:

#### REVENUES

Delta Galil's revenues in 2006 increased by 3.2% and amounted to \$706.7 million compared to \$684.5 million in 2005.

The following table shows Delta Galil's revenues by geographical area, stated in millions of U.S. dollars and as a percentage of total revenues, for the years ended December 31, 2004, 2005 and 2006:

|                            | YEAR ENDED DECEMBER 31, |       |       |       |       |       |
|----------------------------|-------------------------|-------|-------|-------|-------|-------|
|                            | 2004                    |       | 2005  |       | 2006  |       |
|                            | \$                      | %     | \$    | %     | \$    | %     |
| North America .....        | 334.8                   | 51.2  | 401.1 | 58.6  | 418.0 | 59.1  |
| Europe (mainly U.K.) ..... | 267.5                   | 40.9  | 230.3 | 33.6  | 225.8 | 32.0  |
| Israel .....               | 52.0                    | 7.9   | 53.1  | 7.8   | 60.1  | 8.5   |
| Other .....                |                         |       |       |       | 2.8   | 0.4   |
| Total .....                | 654.3                   | 100.0 | 684.5 | 100.0 | 706.7 | 100.0 |
|                            | =====                   | ===== | ===== | ===== | ===== | ===== |



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In 2006, sales to North America increased by 4.2% to \$418.0 million representing 59.1% of total sales. The increase in sales to North America is attributed mainly to an increase in sales of more fashionable products to Victoria's Secret. Delta Galil's sales to Marks & Spencer, decreased by 3.4% to \$155.8 million in 2006, compared to \$161.3 million in 2005. The decrease in sales to Marks & Spencer is attributed mainly to the decrease in sales in the ladies category due to erosion in selling prices. This decrease was partly offset by an increase in sales in the men's category, both in units and in dollar terms. Delta Galil's sales to the European market, excluding Marks & Spencer, increased by 2.9% to \$53.9 million in 2006 compared to \$52.4 million in 2005. Delta Galil's sales to the Israeli market increased by 13.2% to \$60.1 million in 2006 compared to \$53.1 million in 2005 mainly due to the expansion of Delta Galil's retail store chain and to a better product mix.

Effective January 1, 2005, the World Trade Organization's 148 member nations lifted some of the quotas on apparel and textiles. As a result, some of the textiles and textile apparel manufactured in a member nation will no longer be subject to quota restrictions, although in 2006, some of the quotas from China were re-imposed. This change has allowed retailers, apparel firms and others to import unlimited quantities of apparel and textile items from China, India and other low-cost countries. As a result, prices of textiles and apparel, including our products, have faced downward pressure and may continue to decline. If prices decline faster than we are able to cut costs, our business and results of operations could be affected adversely.

In addition, some large retailers have attempted to bypass private label underwear manufacturers and to contract directly with factories to produce their own products. This is known as "direct sourcing". This trend is occurring in the more basic, mass-market products, in which design is less of a factor having an adverse effect on Delta Galil's sales in those categories.

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The following table shows Delta Galil's revenues by product categories, stated as a percentage of total revenues, for the years ended December 31, 2004, 2005 and 2006:

|                                | YEAR ENDED DECEMBER 31 |       |       |
|--------------------------------|------------------------|-------|-------|
|                                | 2004                   | 2005  | 2006  |
| Ladies' Intimate Apparel ..... | 53.6%                  | 61.1% | 57.8% |
| Socks .....                    | 23.0                   | 20.2  | 19.3  |
| Men's Underwear .....          | 12.9                   | 11.1  | 14.7  |
| Leisurewear .....              | 3.7                    | 3.1   | 3.6   |
| Babywear .....                 | 4.4                    | 2.5   | 3.3   |
| Fabrics and Others .....       | 2.4                    | 2.0   | 1.3   |
|                                | -----                  | ----- | ----- |
| Total .....                    | 100%                   | 100%  | 100%  |
|                                | =====                  | ===== | ===== |

The decrease in revenues in the Ladies Intimate Apparel in 2006 compared to 2005 is attributed mainly to the decrease in sales to Marks & Spencer, See "-Overview". The decrease in revenues in the Socks category in 2006 compared to 2005 is attributed mainly to the decrease in sales in North America due to Delta Galil's decision to close its Canadian activity. The increase in revenues in the men's category in 2006 compared to 2005 is mainly due to a general increase in orders from most of our customers and as a result of

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introduction of the new Real Cool Cotton products.

### REORGANIZATION PLAN IN 2006

As part of the changes Delta decided to make in its organizational structure, its management has decided during the second quarter of 2006 to focus its Chinese operations on product development, as well as procurement of finished goods and raw materials. As a result, Delta Galil has decided to close its sewing plant in China and to concentrate Far East self-production in Thailand. This decision is also due to re-imposition of quotas on production in China starting in 2006.

The closure of the sewing plant in China resulted in a total restructuring cost of \$1.7 million and in the dismissal of approximately 700 employees. From the total cost of \$1.7 million, \$0.5 million was in cash primarily for severance payment and the remaining \$1.2 million were non-cash, impairment of assets.

This measure continues the efficiency efforts Delta Galil commenced in the fourth quarter of 2004, which included the closure of its logistics center in Hungary and continued with its 2005 restructuring plan, which included the following main steps:

- a. Closure of a sewing plant in Central America and a distribution center in New Jersey, both of which served the Delta Galil USA segment, and moving the production of the sewing plant to subcontractors in the Far East. The closure of the sewing plant and the distribution center resulted in total restructuring costs of \$1.1 million and in the dismissal of approximately 1,400 employees.
- b. Closure of a sock manufacturing plant in Toronto, Canada and moving its production to subcontractors in Central America and the Far East. The closure of this plant, resulted in total restructuring costs of \$2.4 million and resulted in the dismissal of approximately 100 employees.
- c. Reduction of manufacturing facilities in Israel and transfer of its operations to lower labor cost countries. This action resulted in total restructuring costs of \$4.1 million and with the dismissal of approximately 585 employees.
- d. Consolidation of various departments into one building in Karmiel, Israel in order to cut maintenance and other overhead costs. This action resulted in a total cost of \$1.1 million.

### RESTRUCTURING PLAN - 2007

In light of continuous changes in the business environment, continued erosion of the selling prices and increased competition, in March 2007 Delta Galil decided to adopt a restructuring plan, organizational changes and additional efficiency measures in order to improve the company's performance and enhance its ability to compete in the market place.

Delta Galil intends to take the following measures:

- a. Closure of some manufacturing facilities in Israel and downsizing of others while transferring them to lower cost countries.
- b. Downsizing manufacturing in Jordan.

- c. Organizational changes in its operational structure, development and design functions, marketing and sales operations, as well as in the finance department in the Company's headquarter in Israel. These changes will contribute to savings in overhead and the leveraging of synergies in these areas in the Israeli operations.
- d. Expanding operations in Egypt.

These measures will include the dismissal of approximately 600 workers in Israel as agreed with employee representative committee. Delta Galil expects to record restructuring expenses of \$10 to \$12 million, or \$0.53 to \$0.64 loss per diluted share in the first quarter of 2007. These expenses include an aggregate of approximately \$5 million in cash, mainly for severance obligations. The remainder, including expenses of between \$5 to \$7 million, comprises non-cash provisions for impairment of assets following closures and downsizing at certain production facilities. The implementation is expected to take place over the course of a year, commencing in the second quarter of 2007.

These steps are being taken further to Delta Galil's restructuring plan that was implemented during 2005 and 2006. Furthermore, Delta Galil plans additional efficiency measures and overhead reductions in its U.S. and U.K. headquarters.

#### RESULTS OF OPERATIONS

The following table sets forth Delta Galil's results of operations expressed as a percentage of total revenues for the periods indicated:

|   | YEAR ENDED DECEMBER 31 |        |        |
|---|------------------------|--------|--------|
|   | 2004                   | 2005   | 2006   |
| Net revenues .....  | 100.0%                 | 100.0% | 100.0% |
| Cost of revenues .....  | (81.5)                 | (85.1) | (81.3) |
| Gross profit .....  | 18.5                   | 14.9   | 18.7   |
| Selling, marketing, general and administrative expenses ..... | (15.1)                 | (15.6) | (15.2) |
| Amortization of intangible asset .....                        |                        | (0.1)  | (0.1)  |
| Gain (loss) from realization of assets .....                  | 0.1                    | (*)    | 0.1    |
| Impairment of fixed assets .....                              |                        | (1.1)  |        |
| Restructuring expenses .....                                  | (0.1)                  | (1.3)  | (0.2)  |
| Goodwill impairment .....                                     |                        | (0.9)  |        |
| Operating income (loss) .....                                 | 3.4                    | (4.1)  | 3.3    |
| Financial expenses - net .....                                | (1.0)                  | (1.5)  | (2.0)  |
| Other income- net .....                                       | 0.2                    | (*)    |        |
| Income (loss) before taxes on income .....                    | 2.6                    | (5.6)  | 1.3    |
| Income tax benefit (expense) .....                            | (0.4)                  | 0.4    | (0.8)  |
| Income (loss) after taxes on income (tax benefit) ...         | 2.2                    | (5.2)  | 0.5    |
| Share in losses of associated companies - net .....           | (0.1)                  | (*)    |        |
| Minority interests- net .....                                 | (0.2)                  | (0.1)  | (0.1)  |
| Net income (loss) .....                                       | 1.9%                   | (5.3)% | 0.4%   |

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(\*) Less than 0.1%.

### SEGMENT RESULTS

We have seven principal segments: Delta USA, U.S. Upper Market, Europe, Socks, Delta Marketing Israel, Seam-Less and China. Delta USA, U.S. Upper Market and Europe segments are engaged mainly in manufacturing and marketing of men's underwear and ladies intimate apparel to various customers in the U.S. and European markets. The Socks segment is engaged in manufacturing and marketing of socks to various customers in the U.S. and European markets. Delta Marketing Israel is engaged in marketing ladies intimate apparel, men's underwear and socks to various customers in Israel through retail and wholesale operations. Starting in 2006, Delta Galil decided to present separately the results of its Seam-Less segment, which were previously included in the U.S. Upper Market results. The Seam-Less segment is engaged mainly in manufacturing and marketing of ladies intimate apparel products to U.S and European markets. The facility in China ceased manufacturing operations in the second quarter of 2006 and is engaged with product development and purchasing of raw materials and finished products.

Delta Galil made certain changes to the structure of its internal organization in a manner that caused the composition of its reportable segments to change. As a result, Delta Galil has restated the corresponding items of segment information for the prior periods presented in a manner consistent with segment presentation for 2006.

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The following table sets forth Delta Galil's revenues relating to the various segments:

|                                     | REVENUES BY SEGMENT |                |                |
|-------------------------------------|---------------------|----------------|----------------|
|                                     | (\$ MILLION)        |                |                |
|                                     | 2004                | 2005           | 2006           |
| Delta USA(1) .....                  | \$186.3             | \$267.9        | \$269.7        |
| U.S. Upper Market .....             | 90.3                | 75.7           | 95.3           |
| Europe .....                        | 193.8               | 163.5          | 167.3          |
| Socks .....                         | 144.2               | 130.9          | 122.5          |
| Delta Marketing Israel .....        | 46.5                | 49.0           | 54.3           |
| Seam-Less .....                     | 20.0                | 19.6           | 18.0           |
| China .....                         |                     | 0.7            | 1.8            |
| Other and Inter segment revenues .. | (26.8)              | (22.8)         | (22.2)         |
| <b>Total .....</b>                  | <b>\$654.3</b>      | <b>\$684.5</b> | <b>\$706.7</b> |

(1) Including in 2004 \$3.6 million of Burlen revenues, which was acquired in December 2004.

### SALES BY SEGMENT IN 2006 VS. 2005

The increase in sales in 2006 compared to 2005 by the U.S. Upper Market segment is mainly attributed to an increase in sales of more fashionable products to Victoria's Secret. The increase in sales in 2006 compared to 2005 by the Europe segment was achieved by increased intersegmental sales, which were

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manufactured in Egypt and Thailand factories and were part of this segment in 2006, and despite the decrease in sales to Marks and Spencer. The decrease in sales to Marks & Spencer was primarily in the ladies category due to increased competition from the Far East, resulting in loss of sales and erosion in selling prices. The decrease in sales in the ladies category in Marks & Spencer was partly offset by an increase in sales of men's underwear and children's products. Total sales of the European segment to Marks & Spencer decreased by 6% compared to 2005 in dollar terms and by 7% in pounds sterling. The decrease in sales in 2006 compared to 2005 by the Socks segment is primarily attributed to the decrease in sales in North America due to our decision to close the Canadian activity. The increase in sales in 2006 compared to 2005 by the Delta Marketing Israel segment is attributed mainly to the expansion of the retail store chain in Israel and to a better product mix.

### SALES BY SEGMENT IN 2005 VS. 2004

The increase in sales in 2005 compared to 2004 by the Delta USA segment is attributed to the acquisition of Burlen in the fourth quarter of 2004. Burlen's sales in 2005 amounted to \$107.4 million compared to \$3.6 million in 2004. Excluding Burlen, Delta USA sales decreased by 12% compared to 2004, mainly due to a decrease in sales to Wal-Mart explained by a reduction in sales in the ladies category. The decrease in sales by the U.S. Upper Market segment in 2005 compared to 2004, resulted primarily from a decrease in sales to Calvin Klein, especially in the men's' category and to Victoria's Secret due to different product mix and erosion in selling prices. The decrease in sales by the European segment in 2005 compared to 2004, is mainly due to an erosion of approximately 20% in selling prices to Marks & Spencer partly offset by an increase of 4% in units. Other factors that contributed to a decrease in sales by the European segment include: (1) a decrease in volume sales in the ladies category of Marks & Spencer due to increased competition and (2) a decrease in the children's category due to the same and due to the reduction of Marks & Spencer market share in the U.K. in this category. The decrease in sales by the Socks segment in 2005 compared to 2004 is mainly due to erosion of approximately 15% in selling prices especially to Marks & Spencer, partly offset by an increase of 6% in units and to the decrease in sales in North America due Delta Galil's decision to cease its activity in Canada. The increase in sales by the Israeli Market segment in 2005 compared to 2004 is attributed mainly to a different mix of products.

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The following table sets forth Delta Galil's operating results, restructuring expenses and impairment of assets by segment (in \$ million):

|                           | OPERATING INCOME (LOSS) BY SEGMENT<br>INCLUDING RESTRUCTURING EXPENSES<br>AND IMPAIRMENT OF ASSETS |        |        | RESTRUCTURING<br>EXPENSES |      |      | IMPAIRMENT<br>OF FIXED<br>ASSETS |
|---------------------------|--|--------|--------|---------------------------|------|------|----------------------------------|
|                           | 2004   | 2005   | 2006   | 2004                      | 2005 | 2006 | 2005                             |
| Delta USA .....           | \$ 5.9   | \$ 5.7 | \$13.3 |                           | 1.1  |      | 1.5                              |
| U.S. Upper Market .....   | 0.6  | (12.6) | 0.7    |                           | 1.6  |      | 3.5                              |
| Europe .....              | 4.9  | (8.8)  | 7.7    | 1.1                       | 2.0  |      |                                  |
| Socks .....               | 9.1  | (5.0)  | 1.4    |                           | 4.1  |      |                                  |
| Delta Marketing Israel .. | 4.8  | 5.0    | 6.8    |                           |      |      |                                  |
| Seam Less .....           | (1.4)  | (9.2)  | (2.5)  |                           |      |      | 2.4                              |

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|                         |        |          |        |       |       |       |       |
|-------------------------|--------|----------|--------|-------|-------|-------|-------|
| China .....             |        | (2.3)    | (4.1)  |       |       | 1.7   |       |
| Other Adjustments ..... | (1.5)  | (1.0)    | (0.3)  |       | 0.3   |       |       |
|                         | -----  | -----    | -----  | ----- | ----- | ----- | ----- |
| Total .....             | \$22.4 | \$(28.2) | \$23.0 | \$1.1 | \$9.1 | \$1.7 | \$7.4 |
|                         | =====  | =====    | =====  | ===== | ===== | ===== | ===== |

OPERATING INCOME (LOSS) BY SEGMENT IN 2006 VS. 2005

The increase in the operating results of the Delta USA segment in 2006 compared to 2005 is mainly attributed to a \$1.5 million impairment of fixed assets and \$1.1 million in restructuring expenses, both in 2005, which were related to the decision to close a sewing plant in Central America and a distribution center in New Jersey and to a \$2.1 million inventory step-up with respect to the acquisition of Burlen, in December 2004. Higher sales volume in 2006 and improvement in management of surplus inventory also contributed to the increase in the operating results.

The increase in the operating results of U.S. Upper Market segment in 2006 compared to 2005 is mainly attributed to the increase in sales, especially to Victoria's Secret and Calvin Klein and to the fact that the 2005 operating loss included \$6.1 million of restructuring expenses and impairment of assets.

The increase in the operating results of the European segment in 2006 compared to the loss in 2005 is mainly attributed to the implementation of the restructuring plan which included the cease of the activity in East Europe, from a decrease in air freight cost due to improvement in on time deliveries and due to the improved exchange rates of the pound sterling and the Euro versus the U.S. dollar.

The increase in the operating results of the Socks segment from a loss of \$5.0 million in 2005 to an income of \$1.4 million in 2006 is due to \$7.5 million of restructuring expenses and impairment of goodwill included in 2005 results. Excluding the restructuring expenses and goodwill impairment, the operating results decreased from an income of \$2.5 million to \$1.4 million due to lower sales volume and due to erosion in selling prices, especially to Marks & Spencer due to the increased competition from the Far East, offset to some extent by the improved exchange rate of the pound sterling and the Euro versus the US dollar.

The decrease in the operating losses of the Seam-Less segment to \$2.5 million, in 2006 compared to \$9.2 million in 2005 was primarily due to improvement of the manufacturing processes which led to a decrease in failure costs, a better product mix, and also due to the fact that the 2005 operating loss included \$2.4 of impairment of assets.

The increase in the operating losses of the Chinese segment in 2006 compared to 2005 was primarily due to restructuring expenses totaling \$1.7 million due to the cessation of the manufacturing activity during 2006. See "Overview -Reorganization Plan."

OPERATING INCOME (LOSS) BY SEGMENT IN 2005 VS. 2004

The decrease in the operating income of the Delta USA segment in 2005 compared to 2004 is attributed to a \$1.5 million impairment of fixed assets and \$1.1 million in restructuring expenses, both in 2005, which relate to the decision to close a sewing plant in Central America and a distribution center in New Jersey and to lower sales volume, especially to Wal-Mart in the ladies category offset by Burlen's positive contribution of \$9.1 million operating income.

The increase in the operating loss of the U.S. Upper Market segment in 2005 compared to 2004 is attributed to the impairment of fixed assets, which amounted to \$3.5 million, mainly with respect to machinery and equipment in the fabric facility in Israel in connection with the restructuring plan initiated by Delta Galil, which also resulted in an additional \$1.6 million of expenses related mainly to workforce reduction in this facility and other overhead reduction. The operating loss of the US Upper Market segment in 2005 also included a \$2.1 million goodwill impairment, as determined based on the annual test carried out by Delta Galil which indicated a decrease in the segment assets fair value. In addition, the operating results of the US Upper Market segment in 2005 suffered from the decrease in sales volume, especially to Calvin Klein and Victoria's Secret which also resulted in a lower production level in the fabric facility in Israel and in the sewing facility in Jordan.

The decrease in the operating results of the European segment in 2005 compared to 2004 is attributed mainly to the erosion in selling prices to Marks & Spencer, but also to other customers due to the increased competition from the Far East, following the downward pressure on prices as a result of the cancellation of part of the quotas on textile products. Operating results of the European segment in 2005 were also negatively affected by the low production volume in Egypt due to the reduction in sales.

The decrease in the operating results of the Socks segment in 2005 compared to 2004, from \$9.1 million profit to a \$5.0 operating loss, is attributed mainly to the \$4.1 million restructuring expenses due to our decision to cease operations in Canada and to reduce manufacturing operations in Israel. Furthermore the operating loss of the socks segment in 2005, included a \$3.4 million goodwill impairment, as determined based on the annual test carried by Delta Galil which indicated a decrease in the segment assets fair value. Also attributed to the decrease in operating results is the lower sales volume and erosion in selling prices, especially to Marks & Spencer, as well as to other customers due to the increased competition from the Far East and due to operating losses incurred in North America due to our decision to cease our activity in Canada.

Delta Galil started operations in China during the third quarter of 2005. The plant included sewing and cutting executed by approximately 800 employees, focusing on ladies intimate apparel products. The \$2.3 million operating loss of the China facility in 2005 was attributed to the low initial production volume and also included start-up costs.

YEAR ENDED DECEMBER 31, 2006 COMPARED WITH YEAR ENDED DECEMBER 31, 2005 -  
CONSOLIDATED REVENUES

Total revenues in 2006 increased by 3.2% to \$706.7 million compared to \$684.5 million in 2005. The increase in revenues is due mainly to the increase in sales to the US market, mainly to Victoria's Secret, and to the Israeli market.

COST OF REVENUES.

Delta Galil's cost of revenues is comprised mainly of cost of materials, salaries and related expenses, work performed by subcontractors, depreciation and amortization and the changes in inventories of finished products and products in process. While costs associated with depreciation and indirect salaries are generally fixed, cost of materials, work performed by subcontractors and direct salaries are variable. Cost of revenues in 2006

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decreased by 1.5% and amounted to \$574.2 million (81.3% of revenues) compared to \$582.8 million (85.1% of revenues) in 2005. The decrease in the cost of revenues in 2006 compared to 2005 despite the increase in sales is due to the implementation of the restructuring plan and improved production processes and inventory management.

### GROSS PROFIT.

Gross profit in 2006 increased by 30.3% compared to 2005 and totaled \$132.5 million (18.7% of revenues), compared to \$101.7 million (14.9% of revenues) in 2005. The increase in the gross margin is mainly attributed to increased sales, the implementation of the restructuring plan declared in September 2005, shifting self production to subcontractors, and due to favorable exchange rates of the European currencies versus the U.S. dollar.

### SELLING AND MARKETING EXPENSES.

Delta Galil's selling and marketing expenses are comprised mainly of salaries and related expenses, professional expenses, packaging, transportation and delivery, advertising, royalties, depreciation and amortization, commissions and leases. While costs associated with salaries, professional expenses, depreciation and amortization and leases are generally fixed, packaging, transportation, delivery, advertising, royalties and commissions are more variable. Selling and marketing expenses increased by 1.7 % to \$ 88.2 million (12.5% of revenues) in 2006 compared to \$86.7 million (12.7% of revenues) in 2005. The increase in selling and marketing expenses is attributed mainly to higher sales volume.

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### GENERAL AND ADMINISTRATIVE EXPENSES.

General and administrative expenses are comprised mainly of salaries and related expenses, entertainment and travel expenses, professional fees, doubtful accounts and bad debts, depreciation and amortization and other office expenses. General and administrative expenses decreased from \$20.3 million in 2005 (2.9% of revenues) to \$19.6 million in 2006 (2.7% of revenues).

### AMORTIZATION OF INTANGIBLE ASSET.

Intangible asset includes customer relations, derived from the acquisition of Burlen, and is amortized over a period of 20 years. The yearly amortization amounts to \$739 thousands.

### GAIN (LOSS) FROM REALIZATION OF ASSETS.

In 2006 Delta Galil recorded a capital gain of \$0.7 million, mainly from sale of vehicles compared to \$0.1 million capital loss in 2005.

### IMPAIRMENT OF FIXED ASSETS.

During 2006 as a result of the restructuring plan in the Far East, Delta Galil tested the carrying amount of its fixed assets in China and recognized a total impairment of \$1.2 million which is included among restructuring expenses. During 2005 and as a result of the restructuring plan following the change in operation in various divisions and the erosion in profitability, Delta Galil tested the carrying amount of its fixed assets and, as a result, recognized a total impairment of \$9.8 million, of which \$2.4 is



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included among restructuring expenses and \$7.4 million is included among impairment of assets. The fixed assets which were impaired include mainly machinery and equipment in the fabric and seam-less facilities in Israel, and leasehold improvements in real-estate which would be abandoned in connection with Delta Galil's decision to consolidate most of its premises in Karmiel, Israel.

### RESTRUCTURING EXPENSES.

Due to a reorganization plan, restructuring expenses in 2006 amounted to \$1.7 million compared to \$9.1 million in 2005. See "Overview - Reorganization Plan".

### GOODWILL IMPAIRMENT.

In 2006 Delta Galil didn't record any goodwill impairment. In 2005 Delta Galil recorded goodwill impairment expenses in the amount of \$5.5 million of which \$3.4 million relates to the socks segment and \$2.1 million to the U.S. Upper Market segment.

### OPERATING INCOME (LOSS).

Operating income in 2006 amounted to \$23.0 million (3.3% of revenues) compared to an operating loss of \$28.2 million in 2005. Operating income in 2006 included \$1.7 million of restructuring expenses, while 2005 operating loss included \$9.1 million of restructuring expenses and \$12.9 million of impairment of assets. Operating income, excluding the above, increased from a loss of \$6.2 million in 2005 to an income of \$24.6 million in 2006, mainly due to the improved gross profit.

### FINANCIAL EXPENSES - NET.

Financial expenses increased by 32.7% to \$13.6 million in 2006 from \$10.2 million in 2005. Financial expenses are comprised mainly of interest expenses and exchange rate differences.

The increase in 2006 financial expenses compared to 2005 is mainly attributed to the increase in the average interest rates which resulted in additional \$2.0 million interest expenses and due to exchange rate differences relating to the strengthening of the pound sterling versus the U.S. dollar.

### OTHER INCOME- NET.

Other income in 2006 was zero. In 2005 other income included \$0.3 million proceeds from realization of other investment.

### TAXES ON INCOME.

In 2006 Delta Galil recorded tax expenses of \$5.8 million compared to a tax benefit of \$2.3 million in 2005. The effective tax rate in 2006 was 61% compared to 6% in 2005. The high tax expenses in 2006 is mainly attributed to Delta Galil's decision to increase the valuation allowance in the amount \$3.3 million on losses for tax purposes incurred in 2006 in Israel and in China, as it is considered more likely than not that such losses will not be realized.

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### MINORITY INTEREST- NET.

Delta Galil operates sewing facilities in Jordan through a partially owned subsidiary - Century Wear Corporation (WLL). Minority interests in profit of this subsidiary and also 10% of Delta Elastic Tapes, amounted to \$0.5 million in 2006 and in 2005.

### NET INCOME (LOSS).

Net income in 2006 totaled \$3.1 million (0.4% of sales) compared to a loss of \$36.3 million in 2005. The net income in 2006 compared to the loss in 2005 is attributed to the increase in the gross and operating income offset to some extent by the increase in financial expenses and taxes on income.

### YEAR ENDED DECEMBER 31, 2005 COMPARED WITH YEAR ENDED DECEMBER 31, 2004 - CONSOLIDATED REVENUES

Total revenues in 2005 increased by 5% to \$684.5 million compared to \$654.3 million in 2004. Excluding sales of Burlen, which was acquired in the fourth quarter of 2004, sales decreased by 11% compared to 2004. The decrease in revenues is due mainly to an erosion in selling prices, especially to Marks & Spencer and in the European market.

### COST OF REVENUES.

Cost of revenues in 2005 increased by 9.3% and amounted to \$582.8 million (85.1% of revenues) compared to \$533.0 million (81.5% of revenues) in 2004. The increase in the cost of revenues is attributed to the acquisition of Burlen in December 2004. Burlen's 2005 cost of revenues amounted to \$84.9 million (79.1% of Burlen's revenues) compared to \$2.8 million in 2004. The decrease in the cost of revenues excluding Burlen in 2005 compared to 2004 is due to the decrease in sales volumes.

### GROSS PROFIT.

Gross profit in 2005 decreased by 16.1% compared to 2004 and totaled \$101.7 million (14.9% of revenues), compared to \$121.2 million (18.5% of revenues) in 2004. The decrease in the gross margin is mainly attributed to the erosion in selling prices, mainly to the European operation and especially with Marks & Spencer following the change in business environment due to the WTO decision to lift some of the quotas on intimate apparel and textile product coming from the Far East. This allowed retailers, apparel firms and others to import unlimited quantities of apparel and textile items from China, India and other low-cost countries. As a result, prices of textiles and apparel, including our products, have faced downward pressure.

### SELLING AND MARKETING EXPENSES.

Selling and marketing expenses increased by 6.7 % to \$ 86.7 million (12.7% of revenues) in 2005 compared to \$81.2 million (12.4% of revenues) in 2004. The increase in selling and marketing expenses is attributed mainly to the acquisition of Burlen. Burlen's selling and marketing expenses amounted to \$9.1 million in 2005, (8.5% of Burlen's revenues), compared to \$0.7 million in 2004. The increase in the percentage of the selling and marketing expenses of total sales is attributed mainly to increase in freight cost mainly in the European segment due to the transfer of part of its operation from Eastern Europe to the Far East, and to the increased activity in the Israeli market which resulted in higher salaries and advertising costs.

### GENERAL AND ADMINISTRATIVE EXPENSES.

General and administrative expenses increased from \$17.4 million in

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2004 (2.7% of revenues) to \$20.3 million in 2005 (3.0% of revenues). The increase in general and administrative expenses is attributed mainly to the acquisition of Burlen. Burlen's general and administrative expenses amounted to \$3.6 million in 2005, (3.3% of Burlen's revenues), compared to \$0.1 million in 2004.

### AMORTIZATION OF INTANGIBLE ASSET.

The amortization of the intangible asset includes customer relations, derived from the acquisition of Burlen, and is amortized over a period of 20 years.

### GAIN (LOSS) FROM REALIZATION OF ASSETS.

In 2005 Delta Galil recorded a capital loss of \$0.1 million compared to \$0.9 million capital gain in 2004 derived from the sale of real estate in Ireland.

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### IMPAIRMENT OF FIXED ASSETS.

During 2005 and as a result of the restructuring plan following the change in operation in various divisions and the erosion in profitability, Delta Galil tested the carrying amount of its fixed assets and, as a result, recognized a total impairment of \$9.8 million, of which \$2.4 is included among restructuring expenses and \$7.4 million is included among impairment of assets. The fixed assets which were impaired include mainly machinery and equipment in the fabric and seam-free facilities in Israel, and leasehold improvements in real-estate which would be abandoned in connection with Delta Galil's decision to consolidate most of its premises in Karmiel, Israel.

### RESTRUCTURING EXPENSES.

Due to a reorganization plan, Restructuring expenses in 2005 amounted to \$9.1 million. See "Overview- Reorganization Plan" above. Restructuring expenses in 2004 related to the closure of the logistic center in Hungary.

### GOODWILL IMPAIRMENT.

In 2005 Delta Galil recorded goodwill impairment expenses in the amount of \$5.5 million of which \$3.4 million relates to the socks segment and \$2.1 million to the U.S. Upper Market segment.

### OPERATING INCOME (LOSS).

Operating loss in 2005 amounted to \$28.2 million compared to an operating income of \$22.4 million (3.4% of revenues) in 2004. The operating loss is mainly attributed to a decrease in the gross profit derived from the erosion in selling prices and due to the restructuring expenses and the impairment of fixed assets and goodwill.

### FINANCIAL EXPENSES - NET.

Financial expenses increased by 64.0% to \$10.2 million in 2005 from \$6.2 million in 2004 mainly due to increased bank debt, of approximately \$60 million, due to the acquisition of Burlen which resulted in an increase of \$2.6 million financial expenses and also due to the increase in the average interest

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rate. Financial expenses were composed mainly of interest and exchange differences.

### OTHER INCOME - NET.

Other income in 2005 decreased by \$0.7 million compared to 2004. In 2005 other income included \$0.3 million proceeds from realization of other investment. In 2004 other income included \$1.0 million capital gain from realization of the investment in an associated company, as described above "Sales of Arad Towels and Standard Textile (Europe) Ltd".

### TAXES ON INCOME.

In 2005 Delta Galil recorded tax benefits of \$2.3 million compared to tax expenses of \$2.9 million in 2004. The effective tax rate in 2005 was 6% compared to 17% in 2004. The lower tax savings in 2005 is mainly attributed to Delta Galil's decision to create a valuation allowance in the amount of \$8.9 million on losses for tax purposes incurred in 2005 in Israel, as it is considered more likely than not that such losses will not be realized.

### SHARE IN LOSSES OF ASSOCIATED COMPANY.

Delta Galil's share in losses of associated company includes in 2005 and in 2004 its investment in Edomit Ltd., which is accounted for by the equity method. In 2005 this share amounted to a loss of less the \$0.1 million compared to a loss of \$0.2 million in 2004. During the third quarter of 2005 Edomit sold its holding in a hotel and ceased its operation.

### MINORITY INTEREST- NET.

Delta Galil operates sewing facilities in Jordan through a partially owned subsidiary - Century Wear Corporation (WLL). Minority interests in profit of this subsidiary and also 10% of Delta Elastic Tapes, amounted to \$0.5 million in 2005 compared to \$1.4 million in 2004. The decrease in the minority interest in 2005 compared to 2004 is attributed mainly to the decrease in profit of the Jordanian joint venture due to lower production levels.

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### NET INCOME (LOSS).

Loss in 2005 totaled \$36.3 million compared to a net income of \$12.7 million (1.9% of sales) in 2004. The loss in 2005 compared to the net profit in 2004 is attributed to the decrease in gross profit, impairment of fixed assets and goodwill and due to higher financial expenses and low tax benefit.

### CRITICAL ACCOUNTING POLICIES

To improve your understanding of Delta Galil's financial statements, it is important to obtain some degree of familiarity with Delta Galil's principal or significant accounting policies. These policies are described in Note 1 to the Consolidated Financial Statements listed in Item 18. Delta Galil, in conjunction with its audit committee and its external auditors, reviews its financial reporting, disclosure practices and accounting policies annually to ensure that the financial statements developed, in part, on the basis of these accounting policies provide complete, accurate and transparent information concerning the financial condition of Delta Galil. As part of this process,

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Delta Galil has reviewed the selection and application of its critical accounting policies and financial disclosure as at December 31, 2006, and it believes that the Consolidated Financial Statements listed in Item 18 present fairly, in all material respects, the consolidated financial position of Delta Galil as at that date.

In preparing Delta Galil's financial statements in accordance with GAAP, Delta Galil's management must often make estimates and assumptions that may affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures as at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex, and consequently actual results may differ from those estimates. However, Delta Galil believes that, given the facts and circumstances before it at the time of making the relevant judgments, estimates or assumptions, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on Delta Galil's consolidated results of operations, financial position or liquidity for the periods presented in the Consolidated Financial Statements listed in Item 18.

Delta Galil is also subject to risks and uncertainties that may cause actual results to differ from estimates and assumptions, such as changes in the economic and political environment, competition, foreign exchange, taxation and governmental programs. Certain of these risks, uncertainties and assumptions are discussed in Item 3D - Risk Factors and Item 11 - Quantitative and Qualitative Disclosures About Market Risk. Delta Galil considers its most significant accounting policies to be those relating to fixed assets and inventory valuation, both of which, as well as Delta Galil's accounting policy relating to goodwill valuation are discussed below.

### FIXED ASSETS VALUATION

Fixed assets are stated at cost, net of related investment grants. Depreciation is computed using the straight - line method on the basis of the estimated useful life of the assets. Due to rapid changes in technology and due to the materiality of the fixed assets and depreciation rates on its financial results, Delta Galil considers this to be a critical issue. On January 1, 2002 Delta Galil adopted FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". FAS 144 requires that long-lived assets be held and used by an entity, be reviewed for impairment and, if necessary, written down to the estimated fair value, whenever events or changes in circumstances indicate the carrying amount of assets may not be recoverable through undiscounted future cash flows.

Delta Galil's fixed assets cost as of December 31, 2006 amounted to \$188.3 million. Depreciation and amortization expenses with respect to Delta Galil's fixed assets on an annual basis are approximately \$14.1 million. An increase of 1% in the average annual depreciation rates would increase Delta Galil's depreciation and amortization expenses by approximately \$1.9 million per year. A decrease in the annual rates would have the opposite effect.

Delta tests long-lived assets for impairment, in the event an indication of impairment exists. An impairment loss would be recognized, and the assets would be written down to their estimated fair values, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets. See also note 4f of the consolidated financial statements.

### INVENTORY VALUATION

Inventory, which is a material part of Delta Galil's total assets, is valued at the lower of cost or market value. Cost of raw and packaging materials and purchased products is determined mainly on a "moving average" basis. Cost of

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finished products and products in process is determined as follows: the raw material and packaging component -is determined mainly on a "moving average" basis; while labor and overhead is determined on an average basis over the production period. If actual market prices for finished goods prove less favorable than those projected by management, additional inventory write-downs may be

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required. Inventory is written down for estimated obsolescence based upon assumptions about future demand and market conditions. Likewise, favorable future demand and market conditions could positively impact future operating results if inventory that has been written down is sold.

Delta Galil's inventories carrying value as of December 31, 2006 amounted to \$131.6 million. This amount is net of an allowance for specific obsolete and slow-moving inventories in the amount of \$26.7 million.

### VALUATION OF INTANGIBLE ASSETS - GOODWILL

Goodwill represents the excess of cost of investments in subsidiaries acquired over the fair value of the net assets at acquisition. Until December 31, 2001, Goodwill was amortized in equal annual installments usually over a 40-year period, the maximum allowed period under U.S. GAAP. As from January 1, 2002, pursuant to FAS 142, "Goodwill and Other Intangible Assets," goodwill is no longer amortized but rather is tested for impairment annually. Delta completed the transitional impairment review of goodwill on June 30, 2002, as required by FAS 142. The various reporting units, for which separately identifiable cash flow information is available, were identified and the fair values of such reporting units were determined using the net income multiple of comparable publicly traded companies in the textile industry. Consequently, Delta has determined that there is no indication of impairment with respect to goodwill as of January 1, 2002. Delta has selected September 30 as the date on which it will perform its annual impairment test for indefinite life intangible assets. As of December 31, 2005, based on the review made by Delta Galil, the Company recorded Goodwill impairment expenses of \$5.5 million with respect to the U.S. Upper Market and the Socks segments. In 2006 no impairment resulted from the annual review performed. See also note 1g of the consolidated financial statements.

As of December 31, 2006 the goodwill included in Delta Galil's balance sheet amounted to \$57.3 million, of which \$55.5 million relate to the Delta USA segment and the remaining, \$1.8 million relate to the European segment. Based on the annual test, as mentioned above, the asset fair value of these business units are estimated to be higher than their respective book value.

### NEWLY ISSUED AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140" ("FAS 155"). This statement permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation in accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), with changes in fair value of such hybrid financial instrument recognized in earnings. The fair-value election will eliminate the need to separately recognize certain derivatives embedded in hybrid financial instruments under FAS 133.

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FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006 (January 1, 2007, for Delta Galil). Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided that no interim period financial statements have been issued for the financial year. The adoption of this Statement is not expected to have a material effect on Delta Galil's financial statements or its results of operations.

In March 2006 the FASB issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140" ("FAS 156"). This Statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. In accordance with the provisions of FAS 156, separately recognized servicing assets and servicing liabilities must be initially measured at fair value, if practicable. Subsequent to initial recognition, company may use either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. FAS 156 is effective for fiscal years beginning after September 15, 2006 (January 1, 2007, for Delta Galil). Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. Delta Galil does not currently engage in transfers of financial assets and accordingly does not anticipate that the adoption of this statement will have a material effect on its financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 prescribes a comprehensive model for recognizing, measuring and presenting in the financial statements tax positions taken or expected to be taken on a tax return. This Interpretation also provides guidance on derecognition, classification, interest

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and penalties and disclosure requirements for uncertain tax positions. FIN 48 is effective for fiscal years beginning on or after December 15, 2006 (January 1, 2007, for Delta Galil). The provisions of FIN 48 shall be applied to all tax positions upon initial adoption of this Interpretation. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation. The cumulative effects, if any, of applying this Interpretation will be recorded as an adjustment to retained earnings, goodwill, or accumulated gains and (losses) not affecting retained earnings, as appropriate, as of the beginning of the period of adoption. The company is currently evaluating the impact of adopting FIN48 on its financial position, cash flows, and results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective for fiscal years ending after November 15, 2006. Delta Galil adopted SAB

108 in these financial statements and accordingly, follows SAB 108 requirements when quantifying financial statement misstatements. The adoption of SAB No.108

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did not result in corrections of Delta Galil's financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for Delta Galil). Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. Delta Galil is currently evaluating the impact of the provisions of FAS 157 on its financial position and results of operations.

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

### 5.B LIQUIDITY AND CAPITAL RESOURCES

Delta Galil finances its operations mainly from cash flow from operations, supplemented, if needed, by revolving short-term bank loans and long-term bank loans. Delta Galil repays short-term bank loans if the cash flow from operations exceeds the cash needs for operations and investment.

There are no legal restrictions on the ability of Delta Galil's subsidiaries to transfer funds to Delta Galil in the form of dividends, loans or advances.

The following is a breakdown of Delta Galil's cash flows for the last three years in US \$ millions:

|  | YEAR ENDED DECEMBER 31 |          |          |
|--|------------------------|----------|----------|
|  | 2004                   | 2005     | 2006     |
|  | -----                  | -----    | -----    |
| Net cash flow provided by operating activities .....   | \$ 23.0                | \$ 11.6  | \$ 26.3  |
| Net cash flow used in investing activities .....   | (68.9)                 | (14.4)   | (7.6)    |
| Net cash flow provided by (used in) financing activities(*) ..                                   | 50.2                   | (4.7)    | (23.0)   |
| Translation differences on cash equivalents of foreign<br>currency consolidated subsidiary ..... | 0.1                    | (0.1)    | (**)     |
|  | -----                  | -----    | -----    |
| Increase (decrease) in cash and cash equivalents .....   | \$ 4.4                 | \$ (7.6) | \$ (4.3) |
|  | =====                  | =====    | =====    |

(\*) Including payment of dividend to shareholders of \$8.3 million in 2004.

(\*\*) Less than \$0.1 millions.



In 2006, 2005 and 2004 Delta Galil generated excess cash flow from operations of \$26.3 million, \$11.6 million and \$23.0 million respectively. The increase in net cash flow provided by operating activities from \$11.6 million in 2005 to \$26.3 million in 2006 is mainly attributed to the net income in 2006 compared to the loss in 2005. The decrease in the net cash flow used in investing activities is mainly attributed to a decrease in purchase of fixed assets accompanied with increased proceeds from realization of fixed assets and assets held for sale in the amount of \$4.4 million in 2006 compared to \$1.1 million in 2005. Net cash flow used in financing activities in 2006 amounted to \$23.0 million compared to \$4.7 million in 2005. The increase in cash flow used in financing activities in 2006 is attributed mainly to the improvement in Delta's free cash flow which enable decreasing its net bank debt.

We believe that our cash reserves, together with cash from operations, will be sufficient to meet our anticipated cash needs in both the short and long term. However, if, in the future, cash generated from operations is insufficient to satisfy our liquidity requirements, or if our estimates of revenues, expenses or capital or liquidity requirements change or are inaccurate, we may need to raise additional funds. We may also need to raise additional funds, or may seek to take advantage of any capital raising opportunities, to finance expansion plans, develop or acquire new products or technologies, enhance our existing product or respond to competitive pressures. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms or at all, which could limit our ability to grow and carry out our business plan.

BANK DEBT

Set forth in the table below are Delta Galil's bank debt for the last three years in US \$ millions:

|  | YEAR ENDED DECEMBER 31 |         |         |
|--|------------------------|---------|---------|
|  | 2004                   | 2005    | 2006    |
| SHORT-TERM:                              |                        |         |         |
| Bank loans .....                         | \$ 55.6                | \$ 80.6 | \$107.1 |
| Current maturities of long-term loans .. | 27.9                   | 29.5    | 16.9    |
| Total Short-term .....                   | 83.5                   | 110.1   | 124.0   |
| LONG-TERM:                               |                        |         |         |
| Total Long-term bank loans .....         | 98.4                   | 68.8    | 32.4    |
| Total Debt .....                         | \$181.9                | \$178.9 | \$156.4 |

Delta Galil has incurred bank debt mainly for acquisitions, working capital, capital expenditures and general corporate purposes. Delta Galil's bank loans bear interest at annual variable rates, which were approximately 6.4% on average for the year ended December 31, 2006 and are secured by liens on Delta Galil's assets and part of its subsidiaries. Delta Galil's bank loans are issued under secured bank lines of credit of up to \$269.2 million of which, as of December 31, 2006, Delta Galil had \$90.2 million available for additional borrowings under the same prevailing rates.

Delta Galil's bank lines of credit permit either short-term or long-term borrowings and letters of credits. All of Delta Galil's short-term loans have maturities of up to three months. Part of Delta Galil's borrowings is

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for shorter periods in order to maintain cash management flexibility. Long-term bank loans mature in periods up to November 2009. Delta Galil and part of its subsidiaries have granted each other guarantees for each other's indebtedness.

Delta Galil USA Inc., a subsidiary of Delta Galil is a party to a credit agreement, dated December 9, 2004, with Bank Leumi U.S.A and Bank Hapoalim B.M. Borrowings under the credit agreement are secured by substantially all of the assets of the subsidiary. As of December 31, 2006, the credit agreement provided for \$22.5 million in long term loans, and \$60 million are short term loans. The loan bears interest at a variable rate that is linked to the Libor. As of December 31, 2006, the interest rate on the long term loan was 7.0% and on the short-term credit was 6.75%. As of December 31, 2006, the unutilized credit line was \$15.0 million.

The credit agreement included covenants based on (1) the ratio of Delta Galil USA's earnings before interest, taxes, depreciation and amortization, or EBITDA, to fixed charges; (2) the ratio of net worth to total assets of Delta Galil USA; and (3) the ratio of the sum of Delta Galil USA's (a) loans (b) letters of credit, and (c) acceptances to EBITDA.

Delta Galil USA and the banks amended the credit agreement in January and May 2006. The material changes contained in those amendments were the following: a prepayment of \$25 million of the principal amount of the long term loan; a reduction in the quarterly payment on the long term loan from \$3.5 million to \$1.9 million; an extension of the expiration date of the revolving loan facility from January

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15, 2006 to January 31, 2007; a deposit of \$4 million with Bank Leumi USA and a pledge of that deposit to the banks, an increase of 0.25% in the interest rate; and a change of the covenant mentioned above as follows:

1. The ratio of Delta Galil USA's EBITDA to fixed charges, as defined in the credit agreement, may not be below 1 to 1 for each three -month period ended June 30, September 30, and December 31, 2006, with such ratio rising to 1.5 to 1 for the twelve months ending March 31, June 30, September 30, and December 31, 2007, and 1.6 to 1 for the twelve months ending March 31, June 30, September 30, and December 31 2008 and 2009;
2. The ratio of net worth to total assets of Delta Galil USA may not be below 0.25 to 1 for the twelve months ended March 31, 2006 and June 30, 2006, and a ratio of 0.28 to 1 for the twelve months ending September 30, 2006 and for the twelve-month period ended December 31, 2006, with such ratio rising to 0.4 to 1 for the twelve months ending March 31, 2007 and for the end of each subsequent quarter until maturity;
3. The ratio of the sum of Delta Galil's (a) loans (b) letters of credit, and (c) acceptances (or, collectively, debt) to EBITDA may not exceed 6.70 to 1 for the twelve months ended March 31, 2006; 5.70 to 1 for the twelve months ended June 30, 2006, and 4.0 to 1 for the twelve months ended each of September 30, 2006 and December 31, 2006, with such ratio rising to 3.5 to 1 for the twelve months ended March 31, June 30, September 30, and December 31, 2007, 3.0 to 1 for the twelve months ending March 31, 2008 and for each twelve months period ending at the end of each subsequent quarter until maturity.

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In July 2006, Delta Galil USA and the banks further amended the credit agreement to revise, among other things, the prepayment terms of the term loan.

In January 2007, Delta Galil USA and the banks entered into Amendment no. 4 to the credit agreement. The material changes contained in this amendment are the following: a prepayment of the outstanding long term loan in the principal amount of \$22.5 million; an increase of the short term revolving loan from \$60 million to \$90 million, a change to the term loan interest rate to LIBOR + 1.5%; an extension of the expiration date of the revolving loan facility from January 31, 2007 to January 31, 2008; a subordination of Delta Galil's loan to Delta Galil USA in the amount of \$20 million for a period ending December 1, 2009; a conversion of \$5 million of the outstanding Delta Galil's loan to Delta Galil USA into equity of Delta Galil USA which was executed on December 31, 2006.; a release of the \$4 million deposit with Bank Leumi USA; a change to the financial covenants as follows:

1. The ratio of net worth to total assets of Delta Galil USA may not be below a ratio of 0.28 to 1 as of December 31, 2006 and as of March 31, June 30 and September 30, 2007, and a ratio of 0.3 to 1 as of December 31, 2007;
2. The net worth of Delta Galil USA may not be less than \$60 million as of December 31, 2006 and as of March 31, June 30 and September 30, 2007, and \$65 million as of December 31, 2007; and
3. For the twelve month period ending December 31, 2006, and for the rolling twelve month period ending on each subsequent fiscal quarter thereafter, Delta Galil USA shall have a profit of at least \$1.00.

### WORKING CAPITAL AND CAPITAL EXPENDITURES

Working capital at December 31, 2006 was \$54.9 million, compared to \$80.9 million at December 31, 2005. The decrease in the working capital is attributed to the increase in short term loans replacing long term loans and to the decrease in inventory. Delta Galil believes that its working capital is sufficient for its present requirements. Delta Galil has no material commitment for capital expenditures.

### 5.C RESEARCH AND DEVELOPMENT

Delta Galil has strong in-house creative teams of designers and technology experts, consisting of fashion designers, textile designers, yarn experts, knitting experts and dyeing and finishing experts. Delta Galil's design and development expenses amounted to approximately \$28 million in 2006, compared to \$29 million in 2005 and \$25 million in 2004.

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### 5.D TREND INFORMATION

Please see "Item 3. Risk Factors - Recent Changes in World Trade Organization quotas could put pressure on apparel prices," and "Item 3. Risk Factors - If private label customers produce their own products and bypass manufacturers such as Delta Galil, our sales could decline." See also "Item 5. Operating and Financial Review and Prospects" and "Item 4. Information on the Company" for trend information.

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### 5.E OFF-BALANCE SHEET ARRANGEMENTS

Delta Galil does not have any off-balance sheet arrangements that have or are reasonably likely to have an effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material except hedging transactions, see Item 11 "Quantitative and Qualitative Disclosures About Market Risk".

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### 5.F CONTRACTUAL OBLIGATIONS

Set forth below are our contractual obligations and other commercial commitments as of December 31, 2006:

| CONTRACTUAL OBLIGATIONS                  | PAYMENTS DUE BY PERIOD |                     |            |                      |
|--|------------------------|---------------------|------------|----------------------|
|  | TOTAL                  | LESS THAN<br>1 YEAR | 2- 4 YEARS | MORE THAN<br>5 YEARS |
|  | (U.S. \$ IN MILLIONS)  |                     |            |                      |
| Long-Term Debt (1) .....                 | 54.0                   | 19.5                | 34.5       |                      |
| Capital Lease Obligations .....          | 0.9                    | 0.1                 | 0.3        | 0.5                  |
| Operating Leases .....                   | 48.4                   | 8.7                 | 19.1       | 20.6                 |
| Minimum guaranteed royalties .....       | 9.9                    | 4.3                 | 5.6        |                      |
| Letter of credits and bank guarantees .. | 26.8                   | 22.8                | 3.8        | 0.2                  |
|  | -----                  | -----               | -----      | -----                |
| Total Contractual Cash Obligations ..... | 140.0                  | 55.4                | 63.3       | 21.3                 |
|  | =====                  | =====               | =====      | =====                |

(1) Includes expected interest expenses on long-term debt, based on interest rates in effect as of December 31, 2006. In January 2007, the credit agreement between Delta Galil USA and Bank Hapoalim and Bank Leumi USA was amended. In connection with this amendment, Delta Galil USA pre-paid the outstanding long term loan in the principal amount of \$22.5. As a result, Delta Galil USA's term loan is zero and the Delta's consolidated long term debt as of January 31, 2007 is as follows: \$31.5 (Total); \$11.7 (less than one year); \$19.8 (2-4 years); and \$0 (more than 5 years).

See Item 11: "Quantitative and Qualitative Disclosures About Market Risk" regarding obligations related to forward currency contracts.

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### ITEM 6: DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

#### 6.A DIRECTORS AND SENIOR MANAGEMENT

The directors and executive officers of Delta Galil are as follows:

| NAME        | AGE | POSITION                           |
|-------------|-----|------------------------------------|
| ----        | --- | -----                              |
| Dov Lautman | 71  | Chairman of the Board of Directors |

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|                      |    |  |
|----------------------|----|--|
| Isaac Dabah(3)       | 49 | Director and Vice Chairman of the Board of Directors |
| Aviram Lahav         | 48 | President and Chief Executive Officer                |
| Yossi Hajaj          | 39 | Senior Vice President & Chief Financial Officer      |
| Tom Witthuhn         | 52 | Senior Vice President & CEO of Delta Galil USA       |
| Imad Telhami         | 48 | Senior Vice President & Chief Operation Officer      |
| Esti Maoz            | 59 | Senior Vice President & Chief Marketing Officer      |
| Israel Baum(2) (3)   | 68 | Director   |
| Gideon Chitayat(3)   | 67 | Director   |
| Aharon Dovrat        | 76 | Director   |
| Harvey M. Krueger    | 78 | Director   |
| Noam Lautman         | 38 | Director   |
| Giora Morag(1) (2)   | 62 | Director   |
| Amnon Neubach(1) (2) | 62 | Director   |
| Dan Propper          | 66 | Director   |
| Arnon Tiberg         | 63 | Director   |
| Leah Perez           | 57 | Director   |

(1) External Director.

(2) Member of the Audit Committee.

(3) Mr. Dabah, Mr. Chitayat and Mr. Baum are nominees of GMM Capital LLC, pursuant to a Shareholders Agreement between GMM Capital and the Lautman Group concerning the election of directors.

DOV LAUTMAN is the founder of Delta Galil and has served as the Chairman of the Board of Directors since 1975 and as President and Chief Executive Officer from February 2006 till October 2006. From 1975 to 1996, Mr. Lautman was the Chief Executive Officer of Delta Galil. From 1986 to 1993, Mr. Lautman served as President of the Manufacturers Association of Israel and as the Chairman of the Coordinating Bureau of Economic Organizations of Israel. From 1993 to 1995, Mr. Lautman was the Prime Minister's Special Emissary for Economic Development. Since May 2001, Mr. Lautman has served as the chairman of the executive council of Tel Aviv University.

ISAAC DABAH has served as a Director of Delta Galil and as Vice-Chairman of Delta Galil's Board of Directors since November 2005. He has been the Executive Director of GMM Capital LLC, one of our principal shareholders, since it was formed in January 2005. From 2003 to 2004, Mr. Dabah was CEO of the Denim Division of Jones Apparel Group, which included brands such as Gloria Vanderbilt, Polo Jeans, L.E.I. From 2002 to 2003, Mr. Dabah was CEO of Gloria Vanderbilt, a division of Jones Apparel Group. From 1993 to 2002, Mr. Dabah was CEO of Gloria Vanderbilt Apparel Corp.

AVIRAM LAHAV has served as the CEO of Delta Galil since November 2006. Mr. Lahav has been Senior Vice President since 1997. He served as CEO of Delta Galil's Innerwear USA operations from March 2004 and was appointed as CEO of the US Upper Market Division of Delta, which merged the former Textile and Innerwear divisions. From 1997 to 2004 he served as the Chief Financial Officer of Delta Galil. From 1993 to 1997, Mr. Lahav was Chief Executive Officer of Europcar/Eurodollar Israel, a car rental company and, from 1991 to 1993, Chief Financial Officer of Mediterranean Car Agency Ltd. Mr. Lahav is a certified public accountant (Isr).

YOSSI HAJAJ has served as Senior Vice President and Chief Financial Officer of Delta Galil since March 2004. From 1999 to 2004 he served as controller and corporate secretary of Delta Galil and from 1997 to 1999 he was Delta Galil's Chief Economist and controller of foreign subsidiaries. Mr. Hajaj is a certified public accountant (Isr.) and holds a B.A. in Accounting and Economics from Tel Aviv University. He was a member of the Investment Committee of Tel Aviv University from 2001 until 2006.

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TOM WITTHUHN has served as the Chief Executive Officer of Delta Galil USA since September 2006. From 1998 to 2006 he served as the Senior Vice President International Operations & Global Licensing of Fruit of the Loom. Prior to that, from 1996 to 1998, Tom served as the Vice President General Merchandise Marketing Manager of Jockey International. From 1991 to 1996 he served as the President of

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the B.D. Baggies Division of Tal Ltd. Mr. Witthuhn holds a B.Sc in Marketing from Madison University of Wisconsin.

IMAD TELHAMI has served as Delta's Chief Operation Officer since January 2007. From 2002 to January 2007, Mr. Telhami has served as Senior Vice President and CEO of Delta's Innerwear USA Operation since 2002. He started his career at Delta in 1983 as a sewing plant manager. He managed several sewing plants until he was re-located to manage Delta's facilities in Scotland. In 1996 he returned to Israel when he was promoted to Lingerie Operation Director. In 1999 he was promoted to Director of Delta's Marks and Spencer Operations. Mr. Telhami holds a B.Sc in Industrial Management from Shenkar College in Israel. In March 2004 Mr. Telhami was promoted to SVP and CEO of Delta Galil's European division.

ESTI MAOZ has served as Delta's Chief Marketing Officer since January 2007. Ms. Maoz has been with Delta Galil since its inception in 1975, and has served as Senior Vice President, Global Development and Marketing since November 2002 until January 2007. From September 1991 through October 2002, Ms. Maoz served as the President of Delta Textiles (New York) Ltd. During these years, Ms. Maoz developed and managed the marketing operations within North America. In 1987 Ms. Maoz established the new Ladies Underwear Division and managed the Division through 1991. From 1984 through 1987 Ms. Maoz served as the Corporate Director of Product Development and Design. From 1978 through 1984 Ms. Maoz served as the Manager of all the sewing plants in Delta Galil. Ms. Maoz studied Business and Marketing at the Haifa University in Haifa, Israel. Since April 2005, Ms. Maoz has served on the Board of Directors of Bagir Ltd.

ISRAEL BAUM has served as a Director of Delta Galil since December 2005. He is currently an entrepreneur, and served as the Chief Executive Officer of Litam Clothing Ltd., an Israeli apparel manufacturer, from 1994 to 2004. From 1998 to 2005 Mr. Baum served on the Board of Directors of Macpell Industries Ltd., an Israeli apparel company listed on the Tel Aviv Stock Exchange. Mr. Baum holds a B.Sc. in Industrial Engineering and Management from Temple University in Philadelphia.

GIDEON CHITAYAT, has served as a director since November, 2005. He is the chairman and CEO of General Management and Business Strategy Consultant (GMBS) Ltd. since 1985. Dr. Chitayat has served as a consultant to Chief Executive Officers and to Chairmen of Boards of Directors of several leading Israeli companies and entities in diversified fields in Israel. His main area of consultancy is competitive strategy. Dr. Chitayat currently serves on the board of directors of Paz Oil Industries Ltd., Machtshim Agan Ltd. and Teva-Israel, a subsidiary of Teva Pharmaceutical Industries Ltd. Dr. Chitayat served on the board of directors of Bank Hapoalim from 2000 until 2006. Dr. Chitayat holds a Ph.D. and an M.A. in Business and Applied Economics from the Wharton School of the University of Pennsylvania, and a M.B.A. (with honors) and B.A. (in Economics) from the Hebrew University in Jerusalem. Dr. Chitayat has held numerous academic positions at leading business schools in the United States and Israel. Dr. Chitayat has published numerous articles and a book on corporate, boards of directors and business issues.

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AHARON DOVRAT has served as a Director of Delta Galil since December 1998. Mr. Dovrat is the chairman of Dovrat & Co. Mr. Dovrat serves as a Director of Cognifit Ltd., DS Polaris Ltd., and Solgood Communication Ltd. Until April 2005 Mr. Dovrat served as a Chairman of Isal Ltd. and as a Director of Technomatix Technologies Ltd. Until 2004 he served as a Chairman of Alvarion Ltd. From 1992 to 1998 Mr. Dovrat was the chairman of the Dovrat, Shrem & Co. S.A., an investment banking firm established in 1991, as well as a Director of Domicar Ltd., Investment Company of Bank Hapoalim Ltd., Oshap Technologies Ltd. and Ordan Industries Ltd. Until 1991 Mr. Dovrat served as managing Director of Clal (Israel) Ltd., one of Israel's largest public investment companies.

HARVEY M. KRUEGER has served as a Director of Delta Galil since August 1999. Mr. Krueger is Vice Chairman of Lehman Brothers and has been involved with that firm and Kuhn Loeb & Co., one of its constituent firms, since 1959. Mr. Krueger currently serves as a Director of Chaus Inc., and is also Chairman of Stockton Partners Inc. In addition, Mr. Krueger is former Chairman of the Peres Center for Peace, former Chairman of Cooper-Hewitt National Design Museum and the Smithsonian Institution, former and honorary Chairman of the Hebrew University of Jerusalem, and a member of the Board of Directors of Beth Israel Medical Center (NY) and Continuum Health Partners.

NOAM LAUTMAN has been a Director of Delta Galil since October 2001. Mr. Lautman served as Director for New Ventures and Strategic Business Planning at Teva Pharmaceutical Industries Ltd (Nasdaq: TEVA) from 2002 to 2006. Mr. Lautman previously served in various managerial positions in several Israeli companies operating in the high-tech field. Mr. Lautman serves as the Chairman of the Board of Directors of Browzwear Ltd and as a Director of Nasvax Ltd. (TASE: NSVX). Mr. Lautman holds a B.Sc in Computer Science and Mathematics and an MBA from New York University. Mr. Lautman is the son of Dov Lautman, the Chairman of the Board of Directors of the Company.

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GIORA MORAG has served as a director of Delta Galil since September 2003. Mr. Morag worked at Bank Hapoalim B.M., for 27 years, until 2002. Mr. Morag held a variety of managerial positions during his career, most recently as the General Manager of the bank's UK branches. From 1996 to 1999 Mr. Morag served as General Manager of American Israel Bank Ltd, a wholly owned subsidiary of Bank Hapoalim. As of October 2006 Mr. Morag functions as an external director of Union Bank of Israel. Mr. Morag studied economics and political science at the Hebrew University.

AMNON NEUBACH has been an independent business consultant since 1997. From January 2001 until May 2003, Mr. Neubach served as the Chairman of the Board of Directors of Pelephone Communications Ltd., an Israeli mobile phone company. From 1995 to 1997, Mr. Neubach served as country advisor to Goldman Sachs in Israel, and from 1990 to 1994 he served as the Minister of Economic Affairs at the Israeli Embassy in Washington, D.C. Mr. Neubach serves as an external director of Mind CTI Ltd. (Nasdaq: MNDO), a software company, Aspen Building and Development Ltd. (TASE: ASBD), a real estate company, Leumi Card (subsidiary of Bank Leumi in Israel Ltd.); and as a director of Direct Insurance - IDI Ltd., a private Israeli insurance company. Mr. Neubach received a B.A. in economics and business administration and an M.A. in economics from Bar-Ilan University.

DAN PROPPER has served as a Director of Delta Galil since 1986. Mr. Propper has been the Managing Director of the OSEM Group of Companies since

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1981. In April 2006, he stepped down as CEO and become active chairman of the OSEM group. Until June 1999, Mr. Propper was the President of the Manufacturers Association of Israel and Chairman of the Coordinating Bureau of Economic Organizations of Israel. Mr. Propper is also a member of the Board of Directors of The Weizmann Institute, the Technion, Israel Institute of Technology and Ben Gurion University as well as a member of the executive committees of Tel-Aviv University, and Chairman of the Boards of Directors of various industrial and high tech companies. Mr. Propper received his B.Sc. (summa cum laude) in Chemical Engineering, and food Technology from the Technion -Israel Institute of Technology.

ARNON TIBERG has served as a Director of Delta Galil since March, 2006. He served as Delta Galil's President and Chief Executive Officer from 1996 until January 2006. Mr. Tiberg previously served as a Director of Delta Galil from 1990 until becoming the Chief Executive Officer in 1996. He is presently a Director of Nilit Ltd., Ransys Ltd., Kali Insurance Agency Ltd., and The First International Bank of Israel Ltd. Mr. Tiberg is also the Chairman of the Academic Club of the Israeli Friends of the Tel Aviv University.

LEAH PEREZ has served as a Director of Delta Galil since October 2006. Ms. Perez has been the Head of the Fashion Design Department of Shenkar College of Engineering and Design since September 2006, and also held that position from 1994 to 2003. From 2003 to 2006 she served as Cultural Attache at the Israeli Embassy in Bogota, Colombia. Ms. Perez has curated numerous art, design and fashion design shows around the world and has published a number of articles on art. Ms. Perez earned a B.A. in History of Art and History of the Western World from Haifa University and an M.A. in History of Art from the Hebrew University in Jerusalem.

### 6.B COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

The directors of Delta Galil, other than Dov Lautman who is also an employee of Delta Galil, and the directors designated by GMM Capital other than Isaac Dabah, receive a fixed annual compensation of approximately \$9,100 for their services on the Board of Directors or on any committee thereof. In addition, a sum of approximately \$335 is paid for attending each Board or Board committee meeting and directors are reimbursed for certain approved expenses incurred in connection with their services to Delta Galil. In 2006, Delta Galil's expenses for directors' compensation amounted to a total of approximately \$128,000. The following table sets forth the aggregate compensation paid to or accrued on behalf of all directors and executive officers of Delta Galil as a group for the year ended December 31, 2006.

|  | SALARIES, DIRECTORS' FEES,<br>COMMISSIONS AND BONUSES | PENSION, RETIREMENT AND<br>SIMILAR BENEFITS |
|--|---|---|
|  | -----   | -----                                       |
| All directors and executive officers<br>(consisting of 17 persons) | \$2.5 million   | \$0.1 million                               |

As of March 27, 2007, 1,163,758 options to purchase Delta Galil's ordinary shares were outstanding to certain executive officers and key employees (consisting of 6 persons who were granted options). See "Stock Option Plans" below and note 9 of the notes to Delta Galil's consolidated financial statements included in Item 18 of this annual report.



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### 6.C BOARD PRACTICES

#### TERMS OF DIRECTORS

Delta Galil's directors are elected at the Annual Shareholders Meeting to serve until the next annual meeting of shareholders or until their earlier removal or resignation. Delta Galil's Articles of Association provide that the directors may appoint additional directors (whether to fill a vacancy or to expand the Board), provided the number of directors is less than fifteen or such other maximum number approved at a general meeting of shareholders. The Articles of Association also provide that the Board of Directors may delegate all of its powers to committees of the Board as it deems appropriate, subject to the provisions of the companies law.

Under an amendment to the Israeli Companies Law, each Israeli public company is required to determine, no later than April 19, 2006, the minimum number of directors with "accounting and financial expertise" that such company believes is appropriate in light of the particulars of such company and its activities. A director with "accounting and financial expertise" is a person that, due to education, experience and qualifications, is highly skilled and has an understanding of business-accounting issues and financial statements in a manner that enables him/her to understand in depth the company's financial statements and stimulate discussion regarding the manner of presentation of the financial data.

In accordance with the Companies Law, Delta Galil has determined that the minimum number of directors with "accounting and financial expertise" that Delta Galil believes is appropriate, in light of the particulars of Delta Galil and its activities, is two (one of them is an external director). Under the Companies Law, only one of such "experts" is required to be an external director, as described below.

Delta Galil or its subsidiaries have not entered into any service contracts with its non-employee directors that provide benefits upon termination of services.

#### EXTERNAL DIRECTORS AND AUDIT COMMITTEE

Under the Israeli Companies Law, public companies are required to elect two external directors who must meet specified standards of independence. The external directors may not have any economic relationship with the company. External directors are elected by the shareholders. The votes in favor of their election must include at least one-third of the votes of the shareholders attending and voting who are non-controlling shareholders of the company, without taking abstentions into account. This approval requirement need not to be met if the total votes of such non-controlling shareholders who vote against the election represent 1% or less of all of the voting rights in the company. External directors serve for a three-year term, which may be renewed for only one additional three-year term. External directors can be removed from office only by the shareholders at the same majority required to elect them, or by a court. External directors may be removed from office only if they cease to meet the statutory qualifications with respect to their appointment or if they breach their duty of loyalty to the company.

Pursuant to the Israeli Companies Law at least one external director is required to have "accounting and financial expertise" and the other is required to have "professional expertise" or "accounting and financial expertise". A director has "professional expertise" if he or she satisfies one of the following:

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(i) the director holds an academic degree in one of these areas: economics, business administration, accounting, law or public administration;

(ii) the director holds an academic degree or has other higher education, in the main business sector of the company or in an area relevant to his or her position on the board; or

(iii) the director has at least five years experience in one or more of the following (or a combined five years experience in at least two or more of these (a) senior management position in a corporation of significant business scope; (b) senior public office or senior position in the public sector; or (c) senior position in the main business sector of the company.

The above qualifications do not apply to external directors appointed prior to January 19, 2006. However, an external director may not be appointed to an additional term unless: (i) such director has "accounting and financial expertise"; or (ii) he or she has "professional expertise", and on the date of appointment for another term there is another external director who has "accounting and financial expertise" and the number of "accounting and financial experts" on the board of directors is at least equal to the minimum number determined appropriate by the board of directors.

Any committee of the board of directors must include at least one external

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director. An external director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with his or her service.

If, when an external director is elected, all members of the board of directors of a company are of one gender, the external director to be elected must be of the other gender.

Messrs. Giora Morag and Amnon Neubach serve as external directors of Delta Galil. Their terms expire on September 30, 2009 and December 16, 2009, respectively. The board of directors of Delta Galil determined that Mr. Amnon Neubach and Mr. Gideon Chitayat have "accounting and financial expertise" and that Mr. Giora Morag has "professional expertise".

The Companies Law also provides that publicly traded companies must appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by the Companies Law. An audit committee must consist of at least three members and include all of the company's external directors. The chairman of the board of directors, any director employed by the company or providing services to the company on a regular basis, any controlling shareholder or any relative of a controlling shareholder may not be members of the audit committee. An audit committee may not approve an action or a transaction with a controlling shareholder or with an office holder, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

In addition, the Companies Law requires the board of directors of a

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public company to appoint an internal auditor nominated by the audit committee. A person who does not satisfy the Companies Law's independence requirements may not be appointed as an internal auditor. The role of the internal auditor is to examine, among other things, the compliance of the company with applicable law and orderly business practice.

Pursuant to the listing requirements of the Nasdaq National Market, Delta Galil is required to have at least two independent directors on its board of directors and to establish an audit committee, at least a majority of whose members are independent of management. Messrs. Morag, Neubach, and Baum, who we believe meet the definitions of independence under the rules of the Securities and Exchange Commission and the Nasdaq National Market, currently serve on Delta Galil's audit committee.

Nasdaq rules require any foreign issuer that follows home country practice in lieu of any qualitative listing requirement to disclose in its annual reports filed with the Securities and Exchange Commission that it does not follow such qualitative listing requirement and to describe the home country practice followed by the issuer in lieu of such requirement. While Delta Galil does have a board of directors the majority of which meets the independence requirements under Nasdaq rules, and Delta Galil does have an independent audit committee, as described above, Delta Galil has decided to follow home country practice in lieu of having an independent compensation committee and in lieu of obtaining shareholder approval for stock option plans. Home country practice does not require having an independent compensation committee. Shareholder approval will be sought for stock options to be granted to persons for whom such approval would be required under Israeli law, such as directors and controlling shareholders, as well as any plans that require shareholder approval for other reasons, such as to achieve tax benefits for the optionees.

### 6.D EMPLOYEES

As of December 31, 2006, Delta Galil employed approximately 11,000 employees of these, approximately 8,200 were engaged in production, and the remainder performed administrative, marketing, logistics and other functions.

During 2006 following Delta Galil's decision to concentrate it's Far East self production in Thailand and cease it's sewing activity in China approximately 700 employees were dismissed. See "Item 5 - Operating and Financial Review and Prospects - Reorganization plan."

The following table shows the geographical distribution of Delta Galil's employees, as of December 31, 2006:

| COUNTRY        | NUMBER OF EMPLOYEES |
|----------------|---------------------|
| -----          | -----               |
| Egypt          | 4,588               |
| Israel         | 2,075               |
| Jordan         | 2,059               |
| Far East       | 1,489               |
| United States  | 603                 |
| United Kingdom | 186                 |
|                | -----               |
| Total          | 11,000              |
|                | =====               |

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Many factory employees are eligible for bonuses based upon the number of units such employees produce in any given day. Delta Galil has not experienced any significant labor stoppages.

Certain collective bargaining agreements between the General Federation of Labor in Israel, known as the "Histadrut," and the Coordination Bureau of Economic Organizations (including the Industrialists' Association of Israel) are applicable to Delta Galil's employees in Israel. In addition, a collective bargaining agreement relating to members of the Industrialists' Association, which governs employee relations in the textile and clothing industry, applies to all of Delta Galil's textile employees in Israel. These agreements concern, among other things, the maximum length of the work day and the work week, minimum wages, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, under these agreements, the wages of most of Delta Galil's employees are automatically adjusted in accordance with the cost-of-living adjustments as determined on a nationwide basis and under agreements with the Histadrut based on changes in the Israeli consumer price index. The amounts and frequency of such adjustments are modified from time to time.

Israeli law generally requires the payment by employers of severance pay upon the retirement or death of an employee or upon termination of employment by the employer or, in certain circumstances, by the employee. Delta Galil currently funds its on-going severance obligations by making monthly payments to pension funds, employee accounts in a provident fund and insurance policies. In addition, according to the Israeli National Insurance Law, Israeli employees and employers are required to pay specified amounts to the National Insurance Institute. Since January 1, 1995, such amounts also include payments for national health insurance payable by employees. Until June 30, 2005 the payments to the National Insurance Institute are determined progressively in accordance with the wages and range from 10.4% to 16.3% of wages, of which the employee contributes between 43% and 64% and the employer contributes the balance. Due to a change in the Israeli National Insurance Law, starting July 1, 2005, the range is 9.8% to 16.1% of wages, of which the employee contributes between 46% and 65%. Starting January 1, 2006 the range is 8.5% to 17.7% of wages, of which employee contributes between 41% and 68%. Starting January 1, 2007 the range is 7.6% to 17.7% of the wages of which employee contributes between 46% and 68%. A majority of Delta Galil's permanent employees are covered by life and pension insurance policies providing customary benefits to employees, including retirement and severance benefits. Delta Galil generally contributes up to 15.8% (depending on the employee) of base wages to such plans and the permanent employees contribute 5.0% of their base wages.

### 6.E SHARE OWNERSHIP

See table under Item 7: "Major Shareholders and Related Party Transactions".

### STOCK OPTION PLANS

Delta Galil has three stock option plans. The total shares that may be issued upon exercise of all outstanding options represent approximately 12% of the outstanding share capital of Delta Galil excluding 1,206,802 ordinary shares held by the company and 166,031 shares held by a trustee in connection with Delta Galil's stock option plan after taking into account shares issuable upon exercise of these options, as of March 25, 2007.

### 2000 STOCK OPTION PLAN

In June 2000, Delta Galil adopted a stock option plan. Under the plan, options to purchase 809,000 ordinary shares were granted to 70 employees,

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including 100,000 options to Arnon Tiberg, Delta Galil's President and Chief Executive Officer till January, 2006. As of March 25, 2007, 119,375 options that were granted to 20 employees were forfeited, upon the termination of their employment and 371,500 options were expired without being exercised. The options vest over a three-year period and have an exercise price of \$21.07, equal to the Tel Aviv Stock Exchange closing price on the last day of trading prior to the board of directors' approval. The options are to be held in trust by ESOP Trust Company Ltd., as trustee, for a period of at least two years from the date of grant pursuant to the requirements of the Income Tax Ordinance. As of December 31, 2006 all of these options were fully vested and 318,125 options were outstanding under the plan.

### 2002 STOCK OPTION PLAN

In October 2002 Delta Galil adopted an additional stock option plan, under which options to

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purchase up to 1,100,000 ordinary shares may be granted. Under the plan, options to purchase up to 1,004,500 ordinary shares were granted to 97 employees, including 100,000 options to Arnon Tiberg, Delta Galil's President and Chief Executive Officer till January 31, 2006. The options vest over a four-year period and have an exercise price of \$9.00. The options are to be held in trust by ESOP Trust Company Ltd., as trustee, for a period of at least two years from the date of grant pursuant to the requirements of the Israeli Income Tax Ordinance. As of March 25, 2007, all options were fully vested. The options are exercisable over a three-year period, commencing one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batch. Under the same plan, in May 2003 the Company granted 30,000 options to three employees of the group at an exercise price of \$10.76. The options are exercisable over a three years period, commencing one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batch. On March and August 2004 the Company granted 80,000 and 30,000 options respectively to six and one employees of the group respectively at an exercise price of \$15.35 and \$12.74, respectively. The options are exercisable over a three-year period, commencing one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batch. All options granted after January 1, 2003 may be exercised only following the elapse of two years after the end of the year in which the options were granted. As of December 31, 2006, 972,750 options were outstanding under this plan. As of March 25, 2007 options to purchase an additional 112,250 shares remain available for grant under the plan. As of March 25, 2007, 156,750 options that were granted to thirty employees were forfeited upon the termination of their employment, and 15,000 options were exercised by two employees.

### 2006 STOCK OPTION PLANS

In May 2006 the Board of Directors approved two option plans, one for Israeli and other non-U.S. employees and the other for U.S. employees. A total of up to 1,400,000 options, representing approximately 6.5% of Delta Galil's issued capital on a fully diluted basis, may be issued under the plans. Of such number, 1,100,000 options are issuable under the plan for Israeli and other non-U.S. employees and 300,000 options are issuable under the plan for U.S. employees. Each option may be exercised for one ordinary share of Delta Galil's, pursuant to terms of the relevant option plan.

Under the plan options to purchase up to 1,345,018 ordinary shares

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were granted during 2006 as follows: The exercise price of 845,016 options granted in May 2006 is \$8.43 equal to the closing price of the ordinary shares on the Tel Aviv Stock Exchange on May 11, 2006 converted to US dollars based on the exchange rate of the US dollar on that date. The exercise price of 425,000 options granted in June 7, 2006 is \$7.26, equal to the closing price of the ordinary shares on the Tel Aviv Stock Exchange on June 7, 2006 converted to US dollars and the exercise price of 25,002 options granted on June 25, 2006, is \$7.59 equal to the closing price of the ordinary shares on the Tel-Aviv stock exchange on that day. The exercise price of 50,000 options granted on September 21, 2006 is \$9.20, equal to the closing price of the ordinary share on the Tel Aviv Stock Exchange on that day. Of the 1,345,018 options granted, 816,014 were granted to senior employees. The plan for Israeli employees is treated under the capital gains track under Section 102 of the Israeli Income Tax Ordinance. The options granted under the plan for U.S. employees as incentive stock options have certain tax benefits for those receiving the options. The options granted vest over up to a four-year period and are exercisable over a period of three years after vesting. The vesting of 277,000 options, granted to 11 senior employees, is subject to achievement of financial performance goals. Of these options, 141,000 will vest if our pre-tax net income, excluding one-time capital gains, is at least U.S \$27.5 million in 2007, and 136,000 will vest if the Company's pre-tax net income, excluding one-time capital gains, is at least U.S \$32.5 million in 2008. Of these said performance based options, 89,000 were forfeited as of March 15, 2007 in connection with the departure of four employees. As a result, the total number of options subject to 2007 and 2008 goals is 96,500 and 91,500, respectively. The fair value of the option granted, based on the Black and Scholes model, is approximately \$1.8 million and is included in the financial statements over the vesting period.

As of December 31, 2006, Delta Galil had outstanding options under this plan to purchase up to 1,202,732 ordinary shares. As of March 25, 2007 options to purchase an additional 255,270 shares remain available for grant under the plan.

As of March 15, 2007, 200,288 options that were granted to eighteen employees were forfeited upon the termination of their employment.

As of March 15, 2007, 2,435,605 options to purchase ordinary shares were outstanding under all three plans.

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The following table summarizes information regarding options outstanding at December 31, 2006:

|              |                 | NUMBER OF SHARES ISSUABLE UPON EXERCISE OF OPTIONS |  |                                    |
|--------------|-----------------|--|--|------------------------------------|
|              |                 | OUTSTANDING  |  | VESTED &<br>EXERCISABLE            |
| DATE OF PLAN | EXERCISE PRICES | BALANCE AT<br>DECEMBER 31,<br>2006                 | WEIGHTED<br>AVERAGE<br>REMAINING<br>CONTRACTUAL<br>LIFE<br>(YEARS) | BALANCE AT<br>DECEMBER 31,<br>2006 |
| -----        | -----           | -----  | -----  | -----                              |
|              |                 |  |  |                                    |

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|              |         |           |     |           |
|--------------|---------|-----------|-----|-----------|
| June 2000    | \$21.07 | 318,125   | 1.1 | 318,125   |
| October 2002 | \$ 9.00 | 840,250   | 1.6 | 840,250   |
| October 2002 | \$10.76 | 30,000    | 2.1 | 22,500    |
| October 2002 | \$15.35 | 80,000    | 3.1 | 40,000    |
| October 2002 | \$12.74 | 22,500    | 3.3 | 15,000    |
| May 2006     | \$ 8.43 | 702,730   | 5.4 |           |
| May 2006     | \$ 7.26 | 425,000   | 5.5 |           |
| May 2006     | \$ 7.59 | 25,002    | 5.5 |           |
| May 2006     | \$ 9.20 | 50,000    | 5.5 |           |
|              |         | -----     |     | -----     |
|              |         | 2,493,607 |     | 1,235,875 |
|              |         | =====     |     | =====     |

In March 28, 2007 the Company granted 122,000 options to eight employees at an exercise price per share of \$6.95.

Of the total options granted, 120,000 vest and exercisable as follows: first third vest on the second anniversary of the date of grant and are exercisable for three years thereafter, second third vest on the third anniversary of the date of grant and are exercisable for three years thereafter and the final third vest on the fourth anniversary of the date of grant and are exercisable for three years thereafter. The remaining 2,000 options vest and exercisable as follows: first quarter vest on the first anniversary of the date of grant and are exercisable for three years from the second anniversary of the date of grant, second quarter vest on the second anniversary of the date of grant and are exercisable for three years thereafter, third quarter vest on the third anniversary of the date of grant and are exercisable for three years thereafter and the final third vest on the fourth anniversary of the date of grant and are exercisable for three years thereafter.

The fair value of the options granted, based on the Black and Scholes model, is approximately \$0.2 million and will be recognized in the financial statement over the vesting period.

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ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

7A. MAJOR SHAREHOLDERS

The following table sets forth stock ownership information (including all ordinary shares represented by ADSs) as of March 25, 2007, with respect to:

- 1) Each person who is known by Delta Galil to be the beneficial owner of more than 5% of Delta Galil's outstanding ordinary shares; and
- 2) Directors and senior management (on an individual basis);

Except where otherwise indicated, Delta Galil believes, based on information furnished by such owners, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to such shares. The shareholders listed below do not have any different voting rights from any other shareholders of Delta Galil. Other than as disclosed below, none of Delta Galil's directors or executive officers beneficially owns 1% or more of Delta Galil's outstanding ordinary shares.

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| NAME<br>-----                                    | NUMBER OF<br>ORDINARY SHARES<br>BENEFICIALLY-<br>OWNED<br>----- | PERCENT OF<br>ORDINARY<br>SHARES<br>OUTSTANDING (1)<br>----- |
|--|---|--|
| GMM Capital, LLC(2)                              | 5,323,793   | 28.4%  |
| Dov Lautman(3)                                   | 4,644,993   | 24.8%  |
| Menorah Holdings Ltd.(4)                         | 1,095,172   | 5.8%   |
| Arnon Tiberg-Director(5)                         | 647,588   | 3.5%   |
| Aharon Dovrat-Director                           | 30,050  | 0.16%  |
| Harvey Krueger-Director                          | 5,000   | 0.03%  |
|  | -----   | -----  |
| Officers and directors<br>as a group (aggregate) | 11,746,596<br>=====   | 62.68%<br>=====  |

- (1) Based on 18,740,878 ordinary shares outstanding; as of March 25, 2007, excluding 1,206,802 ordinary shares held by the Company and excluding 166,031 ordinary shares held by a trustee in connection with Delta Galil's stock option plans.
- (2) The sole member of GMM Capital, LLC is GMM Trust. The trustees of GMM Trust are Isaac Dabah, Ivette Dabah (Mr. Dabah's wife) and Donald Hecht the administrator trustee.
- (3) Includes 3,264,336 shares held by Nichsei Adinoam Ltd. and 1,380,657 shares held by N.D.R.L. Investments (1998) Ltd., each of which is a company controlled by Dov Lautman. Noam Lautman is also a director of each of these companies.
- (4) Includes shares held by Menorah Holdings Ltd., as well as shares held by pension funds and provident funds affiliated with Menorah.
- (5) Includes 439,150 shares held by Ha'lakuach Ha'Neeman (65) Ltd., a company controlled by Mr. Tiberg and 58,438 held by Mr. Tiberg. Also includes vested options held by Mr. Tiberg to purchase 150,000 ordinary shares, as follows: options to acquire 50,000 ordinary shares have an exercise price of \$21.07 per share converted to NIS on the date of the exercise, and are fully vested. Of these options, 25,000 are exercisable until August 2007 and 25,000 are exercisable until August 2008. Options to acquire an additional 100,000 ordinary shares have an exercise price of \$9.00 per share converted to NIS on the date of the exercise, and are fully vested. Of these options 50,000 are exercisable until November 2007, 25,000 until November 2008 and 25,000 until November 2009.

### SHAREHOLDERS AGREEMENTS

Dov Lautman, the Chairman of the Board of Directors of Delta Galil, and two companies through which he holds shares in Delta Galil, N.D.R.L. Investments (1998) Ltd. and Nichsei Adinoam Ltd., (collectively, the "Lautman Group"), have a shareholders agreement with GMM Capital.

The shareholders agreement provides, among other things, that:

- o GMM Capital is entitled to nominate 30% of the members of Delta Galil's board of directors, excluding external directors, with fractions rounded up to the next whole number, and Mr.



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Lautman is entitled to nominate the remainder of the members of the board, excluding external directors;

- o Delta Galil may not issue, allot or grant options over or conversion rights into its unissued share capital without the prior consent of GMM Capital unless as part of a pro rata distribution of fully paid up bonus shares; and
- o New appointments of a Chief Executive Officer of Delta Galil shall require the consent of GMM Capital.
- o The prior approval of GMM Capital and the Lautman Group shall be required for actions by Delta Galil or its subsidiaries with respect to (i) acquisitions, dispositions or licenses of assets or businesses, other than in the ordinary course of business consistent with past practice, involving consideration with a value of more than 5% of the total assets of the Company, (ii) public issuances or private placements of bonds or similar debt securities or the payment of dividends in any fiscal year in excess of 5% of the total consolidated assets of the Company, (iii) the approval of the annual capital expenditure budget of Delta Galil and any material modification thereof, if the aggregate amount contemplated by such capital expenditure budget to be spent exceeds certain pre-defined thresholds and (iv) any merger, consolidation, recapitalization or equivalent transaction involving Delta Galil (other than certain intercompany transactions) or the commencement of any bankruptcy or insolvency proceedings or liquidation or winding up of the Company; and
- o The approval of the annual operating budget of Delta Galil and any material modification thereof shall require the approval of a majority of the board of directors of Delta Galil.

In addition, the Lautman Group and GMM Capital each granted the other a right to purchase any Delta Galil shares that the other party beneficially owns and proposes to sell to unaffiliated third parties.

The term of the shareholders agreement will expire on the earlier to occur of: (i) the date on which GMM Capital holds less than 10% of the equity rights of Delta Galil and (ii) the date on which the Lautman Group hold less than 10% of the equity rights of the Company, provided that GMM Capital then owns at least 2.5 times the number of shares held by the Lautman Group.

As of March 25, 2007, GMM Capital owned 28.4% and the Lautman Group owned 24.8% of the outstanding ordinary shares of Delta Galil.

As of March 25, 2007, Delta Galil had 21 shareholders of record resident in the United States, accounting for 29.2% of the outstanding ordinary shares. One U.S. shareholder, GMM Capital, holds 28.4% of the outstanding ordinary shares.

### 7B. RELATED PARTY TRANSACTIONS

Transactions made during 2006 with a company held by GMM Capital LLC, one of the main Company's shareholders, in the ordinary course of business, amounted to \$0.5 million of revenues. See "Item 10: Additional Information-Approval of Related Party Transactions under Israeli Law and item 13 to the financial statements."

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## ITEM 8: FINANCIAL INFORMATION

### 8A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See Delta Galil's consolidated financial statements included in Item 18 of this annual report. No significant change has occurred since the date of the consolidated financial statements included herein, except as otherwise described in this report or in other published reports of Delta Galil.

### LEGAL PROCEEDINGS

From time to time, Delta Galil is involved in legal proceedings relating to claims arising out of its operations in the normal course of business, including claims made by employees and former employees.

Delta Galil believes that there are no legal proceedings pending or threatened against it or any of its properties that may have significant effects on its financial position or profitability.

### DIVIDENDS

Delta Galil has distributed cash dividends to its shareholders from time to time in the past and will continue to consider, on a quarterly basis, the payment of dividends to its shareholders. However, Delta Galil does not have an established dividend policy, and the amount of future dividends, if any, will be determined from time to time by the board of directors in light of Delta Galil's earnings, financial condition, capital requirements and other factors.

Following is a breakdown of dividends per ordinary share paid in the last four fiscal years:

| 2003   | 2004   | 2005  | 2006  |
|--------|--------|-------|-------|
| -----  | -----  | ----- | ----- |
| \$0.52 | \$0.45 | --    | --    |
| =====  | =====  | ===== | ===== |

## ITEM 9:

### 9A. OFFER AND LISTING

Delta Galil's ordinary shares have been listed on the Tel Aviv Stock Exchange since 1982. The ordinary shares are not listed on any other stock exchange and have not been publicly traded outside Israel.

In the United States, ADSs evidenced by American Depositary Receipts (ADRs) represent fully paid ordinary shares of Delta Galil and each ADS represents one fully paid ordinary share. The ADSs are issued pursuant to a Deposit Agreement entered into by Delta Galil and The Bank of New York, as depositary. The Bank of New York's address is 101 Barclay Street, New York, New York 10286. On March 25, 1999, trading of Delta Galil's ADSs commenced on the Nasdaq National Market under the symbol DELT.

The table below sets forth for the periods indicated (i) the high and low last reported prices of the ordinary shares (in nominal NIS and dollars) on

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the TASE, and (ii) the high and low sales prices of the ADSs as reported on the Nasdaq since the year 2002. The translation into dollars is based on the daily representative rate of exchange on the last day of each period, as published by the Bank of Israel.

|                                | ORDINARY SHARES |       |       |      | ADS<br>EQUIVALENTS |      |
|--------------------------------|-----------------|-------|-------|------|--------------------|------|
|                                | HIGH            |       | LOW   |      | HIGH               | LOW  |
|                                | NIS             | \$    | NIS   | \$   | \$                 | \$   |
| YEAR ENDING DECEMBER 31, 2002: | 49.35           | 10.99 | 32.89 | 6.76 | 10.83              | 6.69 |
| YEAR ENDING DECEMBER 31, 2003: | 76.80           | 17.19 | 46.71 | 9.76 | 16.97              | 9.33 |
| YEAR ENDING DECEMBER 31, 2004: | 74.40           | 16.81 | 40.20 | 9.19 | 16.15              | 9.35 |
| YEAR ENDING DECEMBER 31, 2005: | 48.38           | 11.05 | 28.00 | 6.10 | 11.35              | 5.96 |
| First Quarter .....            | 48.38           | 11.05 | 38.92 | 8.89 | 11.35              | 9.14 |
| Second Quarter .....           | 41.67           | 9.53  | 29.56 | 6.46 | 9.81               | 6.50 |
| Third Quarter .....            | 36.07           | 8.06  | 28.05 | 6.08 | 8.10               | 5.97 |
| Fourth Quarter .....           | 33.20           | 7.08  | 28.00 | 6.10 | 7.26               | 5.96 |
| YEAR ENDING DECEMBER 31, 2006: | 44.33           | 10.34 | 27.67 | 6.01 | 10.54              | 6.05 |
| First Quarter .....            | 34.86           | 7.48  | 27.67 | 6.01 | 7.47               | 6.05 |
| Second Quarter .....           | 37.75           | 8.09  | 30.05 | 6.71 | 8.41               | 6.55 |
| Third Quarter .....            | 40.46           | 9.42  | 33.07 | 7.45 | 9.50               | 7.11 |
| Fourth Quarter .....           | 44.33           | 10.34 | 36.81 | 8.71 | 10.54              | 8.82 |
| MOST RECENT SIX MONTHS:        |                 |       |       |      |                    |      |
| September 2006 .....           | 40.46           | 9.42  | 34.61 | 7.92 | 9.50               | 7.85 |
| October 2006 .....             | 41.70           | 9.76  | 38.36 | 9.03 | 9.80               | 8.82 |
| November 2006 .....            | 44.33           | 10.34 | 39.67 | 9.26 | 10.54              | 9.07 |
| December 2006 .....            | 40.85           | 9.67  | 36.81 | 8.71 | 9.79               | 8.86 |
| January 2007 .....             | 39.53           | 9.40  | 33.76 | 7.94 | 9.68               | 7.85 |
| February 2007 .....            | 34.14           | 8.03  | 30.29 | 7.19 | 8.27               | 7.40 |

As of March 26, 2007, the last reported price of the ordinary shares on the TASE was NIS 28.85 (\$6.86) and the last reported price per ADS on Nasdaq was \$7.13. Fluctuations in the exchange rate between the NIS and the dollar may affect the price of the ordinary shares on the TASE and, as a result, may affect the market price of the ADSs in the United States.

### 9B. PLAN OF DISTRIBUTION

Not applicable

### 9C. MARKETS

See Item "9A. Offer and Listing".

### 9D. SELLING SHAREHOLDERS

Not applicable

### 9E. DILUTION

Not applicable

### 9F. EXPENSE OF THE ISSUE

Not applicable

ITEM 10: ADDITIONAL INFORMATION

10A. SHARE CAPITAL

Not applicable.

10B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Delta Galil is registered with the Israeli Registrar of Companies as a public company, with registration number 52-002560-2. Delta Galil's Articles of Association provide that Delta Galil's objectives may include any activity permitted by law, and that Delta Galil can also contribute reasonable amounts to worthwhile causes even if such contributions are not based on profit-oriented business considerations.

APPROVAL OF RELATED PARTY TRANSACTIONS UNDER ISRAELI LAW

The Companies Law governs the relationships between a company and its "OFFICE HOLDERS." Under the Companies Law, an Office Holder is a director, general manager, chief business manager, deputy general manager, vice general manager, any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title or any other manager directly subordinate to the general manager.

DISCLOSURE OF PERSONAL INTEREST

A director who has a personal interest in a transaction that is considered at a meeting of the board of directors or the audit committee may not be present during the board of directors or audit committee discussions and may not vote on that matter. If a majority of the members of the audit committee or of the board of directors has a personal interest in the matter, the director can participate and vote at such audit committee or board meeting, provided, however, that if the majority of the members or the directors has a personal interest in the transaction, shareholder approval will be also required.

The Companies Law requires that an Office Holder and any controlling shareholder promptly disclose to the company any personal interest that he may have, including disclosure of any corporation in which he is a 5% or greater shareholder, director or general manager or in which he has the right to appoint at least one director or the general manager. In addition, an Office Holder and any controlling shareholder must disclose any and all material information known to him, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an "EXTRAORDINARY TRANSACTION", the Office Holder or controlling shareholder must also disclose any personal interest held by such person's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing. An Extraordinary Transaction is a transaction that is not in the company's ordinary course of business, or not at market terms or that may materially affect the company's profitability, assets or liabilities.

DIRECTORS' COMPENSATION

Delta Galil's Articles provide that, unless otherwise approved at a general meeting, each director shall be paid the same remuneration as paid to each of Delta Galil's external directors. Remuneration of external directors is limited by regulations issued under the Companies Law. The directors will be entitled to be reimbursed for reasonable expenses incurred by them in performing

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their services as directors.

### BOARD APPROVAL

As more fully described below, depending on the circumstances, approvals of related-party transactions may be required at three levels: board approval, audit committee approval and shareholder approval.

The Companies Law provides that transactions between a company and its office holders as well as transactions with a company in which an office holder has a personal interest, which are not Extraordinary Transactions, require the approval of the board of directors, unless another manner of approval is provided by the articles of association. The transaction may not be approved if it is adverse to the company's interest. All arrangements as to compensation of the General Manager, the Chief Executive Officer and the President require approval of Delta Galil's board of directors. Unless otherwise determined by the board of directors, the compensation arrangements of office holders, other than the directors, General Manager, CEO and/or President, are at the discretion of the General Manager of Delta Galil. With respect to transactions that are related to the terms of service of a director see "Shareholder Approval" below.

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### AUDIT COMMITTEE AND BOARD APPROVAL

The Companies Law requires approval by both the audit committee and the board of directors for, inter alia, the following types of actions or transactions:

- o proposed transactions in which an office holder has a direct or indirect personal interest and which is beyond the scope of the ordinary course of the company's business, which is not in accordance with market conditions or which may materially influence the earnings, assets or liabilities of the company; and
- o transactions concerning exculpation, indemnification or insurance of an office holder, other than a director.

### SHAREHOLDER APPROVAL

The Companies Law also provides that, in addition to approval of the audit committee and the board of directors, the shareholders must approve the following, unless the Companies Law or the regulations promulgated thereunder provides an exemption for such a case:

- o an Extraordinary Transaction between a public company and a controlling shareholder, including a private placement in which a controlling shareholder of the company has a personal interest;
- o an Extraordinary Transaction with a third party in which a controlling shareholder of the company has a personal interest;
- o the terms of employment of a controlling shareholder (or of such person's spouse, siblings, parents, grandparents, offspring, spouse's offspring and the spouses of any of the foregoing), if he is an employee of the company; and if he is an office holder of the company - the terms of his engagement or service; and
- o terms of service of directors, including exculpation, indemnification,

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insurance or compensation and terms of their employment in other positions in the company.

The shareholder approval required for such an Extraordinary Transaction must constitute at least one-third of the voting shareholders who have no personal interest in the transaction and does not include abstentions. The transaction can be approved by shareholders without the required one-third approval, if the total holdings of those shareholders who have no personal interest and voted against the transaction do not represent more than 1% of the voting rights in the company.

### BORROWING POWERS

Article 50 of Delta's Articles of Association provides that Delta Galil may, from time to time, at its discretion, borrow or secure the payment of any sum or sums of money for its purposes. Article 51 provides that Delta Galil may raise the funds for or secure the repayment of such sums in such manner, at such times and upon such terms and conditions as it deems fit and, in particular, by the issuance of bonds, perpetual or redeemable debentures, debenture stock, or any mortgages or charges, on the present or future property of Delta Galil, including its uncalled capital at that time and its called but unpaid capital.

### CHANGE OF CONTROL

The Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would become a 25% shareholder of the company. This rule does not apply if there is already another 25% shareholder of the company or if the acquisition is from a shareholder that holds 25% or more of the voting rights of the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would become a holder of more than 45% of the voting rights of the company, unless there is another person holding at that time more than 45% of the voting rights of the company or if the acquisition is from a shareholder that holds 45% or more of the voting rights of the company.

The Companies Law provides that mergers require the approval of the board of directors and the shareholders of the merging parties. Under a recent amendment to the Companies Law, a merger with a wholly owned subsidiary does not require the approval of the target company's shareholders. Furthermore, a merger does not require approval of the surviving company's shareholders if (i) the merger does not require amending the surviving company's memorandum of association or articles of association and (ii) the surviving company does not transfer more than 25% of its voting power as a result of the merger and pursuant to the transfer no shareholder would become a controlling shareholder. Approval of the surviving company's shareholders would, nevertheless, be required if the other party to the merger, or a person holding more than 25% of the outstanding voting shares or means of appointing the board of directors of the other party to the merger, holds any shares of the surviving company. For purposes of the shareholder

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vote of each party, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares not held by the other party, or by any person, including that person's relatives and any company that person controls, who holds 25% or more of the shares or has the right to appoint 25% or

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more of the directors of the other party, have voted against the merger. Shareholder approval of mergers will be by a simple majority vote cast at a general meeting of shareholders, not counting abstentions.

### SHAREHOLDERS MEETINGS

Annual general meetings of shareholders are held once every year at such time, within a period of not more than 15 months after the last annual general meeting, and convene at such place as determined by the board of directors. The board of directors may call an extraordinary general meetings of shareholders and is obligated to do so upon a written request in accordance with the Companies Law as described below. The Companies Law provides that an extraordinary general meeting of shareholder may be called by the board of directors or by a request by two directors or 25% of the directors in office, or by shareholders holding at least 5% of the issued share capital of the company and at least 1% of the voting rights, or of shareholders holding at least 5% of the voting rights of the company. Delta Galil generally must give advanced notice of a general meeting to its shareholders of record at least twenty-one days prior to the meeting.

### QUORUM; VOTING RIGHTS; RECORD DATE

The required quorum for any general meeting is two or more shareholders present in person or by proxy and holding at least thirty-three and one-third percent (33 1/3%) of the issued voting shares. On all matters submitted to a vote of shareholders, holders of ordinary shares have one vote for each ordinary share. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future. Under the Companies Law, the board of directors can set a record date for the purpose of a shareholder vote. The record date may be between four and twenty-one days before the date of the meeting.

### DIRECTORS

#### ELECTION OF DIRECTORS

Delta Galil's ordinary shares do not have cumulative voting rights with regard to the election of directors. As a result, the holders of ordinary shares that represent at least 51% of the voting power have the power to elect all the directors. Directors are elected annually by the shareholders at the annual meeting. Directors hold office until the conclusion of the next annual meeting or until their removal or resignation at an earlier date. A director is not required to retire at a certain age and need not be a shareholder of Delta Galil.

#### MEETINGS OF THE BOARD OF DIRECTORS

The required quorum for any Board meeting is at least thirty percent (30%) of the current number of directors.

### DESCRIPTION OF SHARE CAPITAL

#### AUTHORIZED SHARES

Delta Galil's authorized share capital consists of 26,000,000 ordinary shares, par value NIS 1.00 per share.

#### TRANSFER OF SHARES; NON-ASSESSABILITY

Fully paid ordinary shares are non-assessable and are issued in registered form. They may be freely transferred pursuant to the Articles of

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Association unless such transfer is restricted or prohibited by another instrument.

### FOREIGN OWNERSHIP

Delta Galil's Memorandum and Articles of Association do not restrict in any way the ownership of ordinary shares by nonresidents of Israel and neither the Memorandum of Association nor Israeli law restricts the voting rights of non-residents of Israel, other than citizens or residents of countries that are in a state of war with Israel.

### DISTRIBUTION OF DIVIDENDS

Delta Galil's ordinary shares are entitled to the full amount of any cash or share dividend, declared by the Company. Delta Galil may declare a dividend to be paid to the holders of ordinary shares in accordance with their rights and interests in the profits of Delta Galil. In the event of liquidation,

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after satisfaction of liabilities to creditors, the assets of Delta Galil will be distributed to the holders of ordinary shares in proportion to the nominal value of their respective holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future by a special resolution of the shareholders of Delta Galil.

Under the Companies Law, dividends may be paid only out of accumulated earnings or out of net earnings for the two years preceding the distribution of the dividends as calculated under the Companies Law. Dividends may be paid only if there is no reasonable concern that the distribution of dividends will prevent the company from meeting its existing and foreseeable obligations as they become due.

The Articles provide that the distribution of cash dividends and the amount to be distributed is made by the board of directors. The distribution of dividends in kind requires shareholder approval after receiving the recommendations of the board of directors.

### MODIFICATION OF CLASS RIGHTS

The Articles may be amended by a resolution approved by the holders of at least 66% of the shares represented at the shareholders' general meeting and voting thereon, without taking abstentions into account. The rights attached to any class of shares such as voting, dividends and the like, unless otherwise provided for by the terms of issue of such class, may be varied with the consent in writing of all of the holders of the issued shares of the class, or with the adoption of a resolution by at least 66% of the ordinary shares present and voting at a shareholders meeting. This special majority is greater than the simple majority required by the Companies Law.

### AMERICAN DEPOSITARY RECEIPTS

The description of American Depositary Receipts appearing in Delta Galil's Registration Statement on Form F-1 (Registration No. 333-10062) filed with the Securities and Exchange Commission on February 26, 1999 is incorporated herein by reference.

### DIRECTORS AND OFFICERS INDEMNIFICATION AND INSURANCE



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Delta Galil has obtained directors' and officers' liability insurance covering the officers and directors of Delta Galil and its subsidiaries for claims arising from wrongful acts they committed in their capacity as an officer or a director. Delta Galil has also issued indemnity undertakings to its office holders to indemnify them for amounts that they may be obligated to pay in litigation related to their service to Delta Galil arising in one of the types of events enumerated in the undertaking. Such indemnification is capped at an aggregate of \$15 million for all office holders in respect of the same series of events, less any amount reimbursed by Delta Galil's directors and officers insurance, PROVIDED however, that the total amount of indemnity may not exceed 25% of the shareholders' equity of Delta Galil on the date of the payment of amounts pursuant to the undertaking.

### 10C. MATERIAL CONTRACTS

Delta Galil entered into an amendment to the Stock Purchase Agreement relating to the acquisition of Burlen Corporation. For a description of this amendment see Item 4 "Information on the Company - Recent Acquisitions". During 2006 and in the beginning of 2007, Delta Galil amended its U.S bank credit agreement. For a description of a recent amendment to the credit facility of Delta Galil USA Inc. see "Item 5 - Operating and Financial Review and Prospects - Liquidity and Capital Resources - Debt." In May 2006, Delta Galil adopted two option plans. For a description see Item 6E "Share Ownership - Stock Option Plans."

### 10D. EXCHANGE CONTROLS

Non-residents of Israel who acquire any of the ADSs or ordinary shares using non-Israeli currencies will be able to convert dividends, liquidation distributions and the proceeds from the sale of such ADSs or ordinary shares, into non-Israeli currencies at the rate of exchange prevailing at the time of conversion provided that Israeli income tax has been paid (or withheld) on such amounts.

Israeli residents are eligible to purchase securities of Israeli and non-Israeli companies, and are eligible to purchase the ADSs or ordinary shares.

### 10E. ISRAELI TAXATION

Following is a short summary of the tax regime applicable to corporations in Israel, with special reference to its effect on Delta Galil. This discussion also includes specified Israeli tax consequences to holders of our ordinary shares and Israeli Government programs benefiting us. The following is not

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intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

### CORPORATE TAX RATE

The regular tax rate in Israel in 2006 is 31%. This rate is currently scheduled to decrease to 29% in 2007, and 25% until the year 2010 for undistributed earnings. However, the effective tax rate of a company, which derives income from an approved enterprise, may be considerably less, as further discussed below.

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LAW FOR THE ENCOURAGEMENT OF INDUSTRY (TAXES), 1969 (THE "INDUSTRY ENCOURAGEMENT LAW")

Delta Galil believes that it currently qualifies as an Industrial Company pursuant to the Industry Encouragement Law. As such, Delta Galil qualifies for certain tax benefits, including amortization of the purchase price of a good-faith acquisition of a patent or of certain other intangible property rights at the rate of 12.5% per annum and the right to file consolidated tax returns with its subsidiaries qualified as an Industrial Company and operating under the same industry. The tax laws and regulations dealing with the adjustment of taxable income for local inflation provide that industrial enterprises such as Delta Galil which qualify as an Industrial Company can claim special rates of depreciation such as up to 40% on a straight line basis for industrial equipment.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any government authority. Delta Galil cannot assure you that it presently qualifies as an "Industrial Company," it will continue to qualify as such in the future, or that the benefits will be granted in the future.

LAW FOR THE ENCOURAGEMENT OF CAPITAL INVESTMENTS, 1959 (THE "INVESTMENT LAW")

Industrial projects of Delta Galil have been granted the status of an "Approved Enterprise" under the Investment Law. This law provides that capital investments in production facilities may, upon application to the Israel Investment Center, be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, i.e., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable profits attributable to the specific program, based upon criteria set in the certificate of approval. In the event that Delta Galil, which has been granted Approved Enterprise status, is operating under more than one approval or that its capital investments are only partly approved (a "Mixed Enterprise"), its effective corporate tax rate will be the result of a weighted combination of the various applicable rates.

Income derived from an Approved Enterprise is subject to a tax rate of 25%, rather than the usual rate in 2006 of 31% (as mentioned above, gradually scheduled to be reduced to 29% in 2007 and to 25% until the year 2010), for a period of ten years, commencing with the year in which the Approved Enterprise first generates taxable income. This period cannot extend beyond 12 years from the year of commencement of operations or 14 years from the year in which approval was granted, whichever is earlier. Income derived from an Approved Enterprise located in Area A, which have been approved after January 1, 1997 is exempt from income tax in the first two years.

Delta Galil first derived income from some of the abovementioned Approved Enterprises in 1999. In 1999, Delta Galil used tax benefits estimated at approximately \$ 1.6 million. Due to losses for tax purposes accumulated prior to 1999 and in the years 2000 - 2006, Delta Galil had not used any of the tax benefits to which it is entitled under these government programs in these years, except with respect to accelerated depreciation on real estate property. The remaining tax benefits may be available for use in future years, under the abovementioned periods of 12 years from the year of commencement of operations and 14 years from the year of the grant of approval.

Under the Approved Enterprise programs, Delta Galil has received grants totaling \$ 1.1 million in 2004 and none in 2005 and 2006. The government of Israel has gradually reduced the investment grants available from 38% of eligible capital expenditures in 1996 to 24% of eligible capital expenditures in

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1998 and thereafter.

This lower grant rate applies to any applications in 1998 or thereafter. There can be no assurance that the Israeli government will not further reduce these investment grants.

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Delta Galil is a "Foreign Investors Company" ("FIC"), as defined by the Investment Law, and is entitled to an extended period of ten years (rather than seven years), commencing with the year in which the Approved Enterprise first generates taxable income. This ten-year period cannot extend beyond 12 years from the year of commencement of operations or 14 years from the year in which approval was granted, whichever is earlier. Delta Galil cannot assure you that it will continue to qualify as an FIC in the future, or that the benefits will be granted in the future.

The benefits available to an Approved Enterprise are contingent upon Delta Galil's fulfilling the conditions stipulated by the Investment Law, regulations published thereunder and the conditions of approval for the specific investments in Approved Enterprises.

In the event that Delta Galil fails to comply with these conditions, the benefits may be cancelled and Delta Galil may be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences to the Israeli consumer price index and interest.

The Israeli Government has enacted legislation in April 2005 that extensively changes the Investment Law. However, according to a provision in this legislation, changes in the Investment Law should not affect approved enterprises plans that were approved as of December 31, 2004 or investments made as of December 31, 2004. For the meantime, this would seem to preserve the benefits for Delta Galil's approved enterprises, as described above. However, there is currently no administrative or judicial guidance relating to the new legislation. Additionally, there are indications that some of the new sections may undergo revision or technical correction. Accordingly, Delta Galil provides no assurances regarding the ongoing application of the Investment Law to current or future Approved Enterprises.

### TAXATION OF NON-ISRAELI SUBSIDIARIES

Non- Israeli subsidiaries are generally taxed based on the tax laws in their countries of residence.

### CAPITAL GAINS AND INCOME TAXES APPLICABLE TO ISRAELI SHAREHOLDERS

Prior to the tax reform, sales of our ordinary shares by individuals were generally exempt from Israeli capital gains tax so long as (1) our ordinary shares were quoted on NASDAQ or listed on a stock exchange in a country appearing on a list approved by the Controller of Foreign Currency and (2) we qualified as an Industrial Company within the definition of the Law for the Encouragement of Industry (Taxes), 1969.

Pursuant to the Tax Reform, generally, capital gains tax is imposed on Israeli residents at a rate of 15% on real gains derived on or after January 1, 2003 and a rate of 20% on real gains derived on or after January 1, 2006 from the sale of shares in : (1) companies publicly traded on the Tel Aviv Stock Exchange; or (2) Israeli companies publicly traded on Nasdaq or a recognized stock exchange or a regulated market outside of Israel as defined in income tax order (definition

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stock exchange), 2004; or (3) companies dually traded on both the Tel Aviv Stock Exchange and Nasdaq or a recognized stock exchange or a regulated market outside of Israel. This tax rate is contingent upon the shareholder not claiming a deduction for financing expenses, and does not apply to: (1) dealers in securities; or (2) shareholders that report in accordance with the Inflationary Adjustments Law, (3) shareholders who acquired their shares prior to an initial public offering (that are subject to a different tax arrangement); (4) a sale to a related party; (5) Where the seller is "substantive shareholder" as defined in the ITO i.e, a person who directly or indirectly, alone or with another, holds at least 10% of one or more categories of means of control in a body of persons, when the shares were sold or at any time within 12 months before the sale, shall be charged tax at a rate of 25%.

The tax basis of shares acquired prior to January 1, 2003, with respect of which the shareholders had been exempted from capital gains tax prior to January 1, 2003, will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

### TAX REFORM LEGISLATION

In July 2002, the Israeli Parliament approved a law introducing extensive changes to Israel's tax law generally effective January 1, 2003. Among the key provisions of this reform legislation are (1) changes which may result in the imposition of taxes on dividends received by an Israeli company from its foreign subsidiaries; and (2) the introduction of the controlled foreign corporation concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or certain capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for withholding tax to be paid upon distribution by the subsidiary in its country of residence.

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### CAPITAL GAINS AND INCOME TAXES APPLICABLE TO NON-ISRAELI SHAREHOLDERS

**CAPITAL GAINS.** The basic capital gains tax rate applicable to corporations effective until December 31, 2002 had been 36%, and the maximum tax rate for individuals was 50%. Effective January 1, 2003, the capital gains tax rate imposed upon sale of capital assets acquired after that date was reduced to 25%; capital gains realized from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after that date that the asset was held. In addition, if the ordinary shares are traded on a recognized stock exchange (including the Tel Aviv Stock Exchange and the NASDAQ), gains on the sale of ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax. Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income.

Under an amendment to the Inflationary Adjustments Law, effective January 1, 1999, corporate investors that hold listed securities (other than corporations solely owned by individuals), will generally be subject to the provisions of the Inflationary Adjustments Law. The Inflationary Adjustments Law stipulates a comprehensive set of rules for determining the gains or losses from the sale of listed securities. Gains from sale of negotiable shares which are subject to the Inflationary Adjustments Law, are taxable at the regular

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corporate tax rate. A literal reading of the Inflationary Adjustments Law, may suggest that its provisions also apply to foreign corporations, although the foreign corporation may have no activity in Israel other than the shareholding in an Israeli company. Consequently, unless a tax treaty exemption is applicable, the capital gain exemption available for individual shareholders may not apply. A 2006 amendment to the Inflationary Adjustments Law removes the uncertainty that foreign entities would not owe capital gains tax on traded securities without the need for an interpretation from the relevant tax treaty.

Under the treaty between the United States and Israel, the capital gain derived by a U.S. taxpayer from the sale, exchange or other disposition of stock in an Israeli corporation would generally be tax exempt when the shareholder did not own, within the 12 month period preceding such sale, exchange or other disposition, shares constituting 10% or more of the voting power in the Israeli corporation.

### DIVIDENDS.

Individuals who are non-Israeli residents are subject to a graduated income tax on income derived from sources in Israel. On the distribution of dividends other than share dividends, income tax is withheld at the rate of 20%, or 15% in the case of dividends distributed from taxable income attributable to an Approved Enterprise, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence and a special certificate is provided.

Under the United States-Israel Tax Treaty, the maximum withholding tax in Israel on dividends paid to a holder of ordinary shares who is a resident of the United States is 25%. This tax rate is reduced to 12.5% for a corporation that has been holding in excess of 10% of the voting rights of Delta Galil during Delta Galil's tax year preceding the distribution of the dividend and the portion of Delta Galil's tax year in which the dividend was distributed. Dividends of an Israeli company derived from the income of an Approved Enterprise will be subject to a dividend withholding tax of only 15%. The withheld tax is the final tax in Israel on dividends paid to non-residents who do not conduct business in Israel.

Residents of the United States will generally have withholding tax in Israel deducted at the source. They may be entitled to a credit or deduction for U.S. federal income tax purposes in the amount of the taxes withheld, subject to detailed rules contained in the United States-Israel Tax Treaty and in U.S. tax legislation.

A non-Israeli resident who has derived interest, dividend or royalty income from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

### UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a general summary of the material U.S. federal income tax considerations applicable to U.S. Holders (as defined below) of ADSs or ordinary shares, who hold such instruments as capital assets (generally, property held for investment). This summary is based on provisions of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), existing and proposed U.S. Treasury regulations promulgated thereunder and administrative and judicial interpretations thereof,

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all in effect as of the date of this annual report and all of which are subject to change (possibly with retroactive effect) and to differing interpretations. In addition, this summary does not discuss all aspects of U.S. federal income taxation that may be applicable to U.S. Holders in light of their particular circumstances or to U.S. Holders who are subject to special treatment under U.S. federal income tax law (including, for example, life insurance companies, dealers in stocks or securities, financial institutions, tax-exempt organizations, persons having a functional currency other than the U.S. dollar, persons subject to the alternative minimum tax and persons who have directly, indirectly or constructively owned 10% or more of the outstanding voting shares of Delta Galil at any time. EACH U.S. HOLDER IS URGED TO CONSULT WITH ITS TAX ADVISOR REGARDING THE TAX CONSEQUENCES OF ITS HOLDINGS, INCLUDING THE EFFECTS OF FEDERAL, STATE, LOCAL, FOREIGN AND OTHER TAX LAWS.

This summary is based in part on representations of The Bank of New York, Delta Galil's depository, and assumes that each obligation provided for in, or otherwise contemplated by, Delta Galil's deposit agreement with The Bank of New York and any related agreement will be performed in accordance with its terms.

As used herein, the term "U.S. Holder" signifies a holder of an ADR evidencing an ADS, or of an ordinary share, who is an individual citizen or resident of the United States, or that is (i) a corporation or partnership created or organized in or under the laws of the United States or any political subdivision thereof; (ii) an estate the income of which is subject to U.S. federal income taxation regardless of its source or (iii) a trust if (A) a U.S. court is able to exercise primary supervision over the trust's administration and one or more U.S. persons have the authority to control all of the trust's substantial decisions or (B) it has validly elected to be treated as a domestic trust under the Code.

### OWNERSHIP OF ADRS, ADSS AND ORDINARY SHARES

In general, for U.S. federal income tax purposes, U.S. Holders of ADRs evidencing ADSs will be treated as the owners of the ordinary shares represented by the ADSs.

### DIVIDENDS PAID ON THE ADSS OR ORDINARY SHARES

A U.S. Holder will generally be required to include in gross income as ordinary dividend income the amount of any distributions paid on the ADSs or ordinary shares (including the amount of any Israeli taxes or depository fees withheld therefrom) to the extent that such distributions are paid out of Delta Galil's current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Distributions in excess of such earnings and profits will be applied against and will reduce the U.S. Holder's tax basis in its ADSs or ordinary shares and, to the extent that they are in excess of such tax basis, they will be treated as a gain from a sale or exchange of such ADSs or ordinary shares. Such dividends will not qualify for the dividends-received deduction applicable in certain cases to U.S. corporations.

Dividends received in respect of ordinary shares or ADSs will generally be treated as foreign source income and be "passive category income" or, in the case of certain U.S. Holders, "general category income" for U.S. foreign tax credit purposes. Subject to the limitations in the Code (including minimum holding period requirements), as modified by the United States-Israel Tax Treaty, a U.S. Holder may elect to claim a foreign tax credit against its U.S. federal income tax liability for Israeli income tax withheld from dividends received in respect of ordinary shares or ADSs. A U.S. Holder who does not elect to claim the foreign tax credit may instead claim a deduction for Israeli income

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tax withheld, but only for a year in which the U.S. Holder does so with respect to all foreign income taxes.

Certain U.S. Holders (including individuals) are eligible for reduced rates of U.S. federal income tax in respect of "qualified dividend income" received in taxable years beginning before January 1, 2011. For this purpose, "qualified dividend income" generally includes dividends paid by a non-U.S. corporation if, among other things, the U.S. Holders meet certain minimum holding periods and the non-U.S. corporation satisfies certain requirements, including that either (i) the shares (or ADSs) with respect to which the dividend has been paid are readily tradable on an established securities market in the United States, or (ii) the non-U.S. corporation is eligible for the benefits of a comprehensive U.S. income tax treaty (such as the United States-Israel Tax Treaty) that provides for the exchange of information. Additional foreign tax credit limitations apply to non-U.S. withholding taxes imposed on qualified dividend income. We believe that dividends paid with respect to our ordinary shares and ADSs, should constitute qualified dividend income for U.S. Federal income tax purposes.

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### DISPOSITION OF ADSS OR ORDINARY SHARES

Upon the sale or other disposition of ADSs or ordinary shares, a U.S. Holder will generally recognize capital gain or loss equal to the difference between the amount realized on the disposition and such Holder's adjusted tax basis in the ADSs or ordinary shares. Gain or loss upon the disposition of the ADSs or ordinary shares will be long-term if, at the time of the disposition, the holding period for the ADSs or ordinary shares exceeds one year. Long-term capital gains realized by U.S. Holders that are individuals are generally subject to a marginal U.S. federal income tax rate that is lower than the ordinary marginal income tax rate. The deductibility of capital losses by a U.S. Holder is subject to limitations.

In general, any gain recognized by a U.S. Holder on the sale or other disposition of ADSs or ordinary shares will be U.S. source income for U.S. foreign tax credit purposes. However, pursuant to the United States-Israel Tax Treaty, gain from the sale or other disposition of ADSs or ordinary shares by a holder who is a U.S. resident (determined under the United States-Israel Tax Treaty) and who sells the ADSs or ordinary shares in Israel may be treated as foreign source income for U.S. foreign tax credit purposes. Any loss on the sale or other disposition of ADSs or ordinary shares may be required to be allocated against foreign source income for U.S. foreign tax credit limitation purposes.

Exchanges, deposits and withdrawals by U.S. Holders of ordinary shares for ADSs will not result in the recognition of gain or loss for U.S. federal income tax purposes.

### PASSIVE FOREIGN INVESTMENT COMPANY

A non-U.S. corporation classified as a passive foreign investment company (a "PFIC") for any taxable year (and in some cases for future taxable years as well) if (i) at least 75% of its gross income consists of passive income (such as certain dividends, interest, rents, royalties and gains from the disposition of certain (types of property) or (ii) at least 50% of the average value of its assets consist of assets that produce, or are held for the production of, passive income. We believe that we were not a PFIC for the year ended December 31, 2006 or for any prior year. However, this conclusion is a factual determination made at the close of each year and is based on, among

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other things, a valuation of our ordinary shares, ADSs and assets, which will likely change from time to time. If we were characterized as a PFIC for any taxable year, a U.S. Holder would suffer adverse tax consequences, including (i) having certain gains realized on the disposition of ordinary shares or ADSs treated as ordinary income rather than capital gains and (ii) being subject to punitive interest charges on certain dividends and on certain gains from the disposition of ordinary shares or ADSs. Furthermore, dividends paid by a PFIC are not eligible to be treated as "qualified dividend income" (discussed above).

### INFORMATION REPORTING AND BACKUP WITHHOLDING

Dividend payments with respect to ordinary shares or ADSs and proceeds from the sale, exchange or other disposition of ordinary shares or ADSs may be subject to information reporting to the IRS and possible U.S. backup withholding. Backup withholding will not apply, however, to a holder who furnishes a correct taxpayer identification number or certificate of foreign status and makes any other required certification or who is otherwise exempt from backup withholding. U.S. persons who are required to establish their exempt status generally must provide IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-U.S. Holders generally will not be subject to U.S. information reporting or backup withholding. However, such holders may be required to provide certification of non-U.S. status (generally on IRS Form W-8BEN or W-8IMY) in connection with payments received in the United States or through certain intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a holder's U.S. federal income tax liability, and a holder may obtain a refund of any excess amounts withheld by filing the appropriate claim for refund with the IRS and furnishing any required information.

### 10F. DIVIDENDS AND PAYING AGENTS

Not applicable.

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### 10G. STATEMENT BY EXPERTS

Not applicable.

### 10H. DOCUMENTS ON DISPLAY

Delta Galil files reports and other information with the SEC. These reports include certain financial and statistic information about Delta Galil, and may be accompanied by exhibits. You may read and copy any document Delta Galil files with the SEC at the SEC's Public Reference Room at 100 F Street N.E., Washington D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms.

The SEC maintains an Internet website at <http://www.sec.gov> that contains reports and other material that are filed through the SEC's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. Delta Galil began filing through the EDGAR system beginning in October 2002.

### 10I. SUBSIDIARY INFORMATION

Not applicable.



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### ITEM 11: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### EXCHANGE RATE RISK

Although Delta Galil is an Israeli company, its functional currency is the U.S. dollar. Delta Galil has operations and sales in many countries that are not denominated in dollars, and is therefore exposed to fluctuations in the rate of exchange between the dollar and those currencies. In 2006, Delta Galil derived 24.3% of its revenues from customers in Pound Sterling, 8.5% of its revenue were in NIS, and 7.6% were in Euros. More than 10% of Delta Galil's expenses were in NIS in 2006.

Some of Delta Galil's expenses in Israel are linked to the Israeli consumer price index. Consequently, Delta Galil is exposed to risk to the extent that the rate of Israeli inflation exceeds the rate of the NIS devaluation in relation to the dollar and to the extent that the timing of such devaluation lags behind inflation in Israel.

In order to reduce the exposure to exchange rate fluctuations between the dollar and other currencies Delta Galil generally carries out currency transactions that hedge part of its exposure in respect of its net income in non-dollar currency for periods of up to 12 months. The financial results in respect of these hedging transactions are reflected in Delta Galil's consolidated financial statements, together with the results of the hedged items, such as revenues and cost of revenues.

As of December 31, 2006, Delta Galil had entered into hedging transactions for the exchange of \$10 million into pound sterling at an average rate of \$1.91 per Pound Sterling for the first quarter of 2007.

Based on current sales volumes, expenses and exchange rates, each one percent devaluation in Pound Sterling or Euro against the dollar on an yearly average would result in a decrease of approximately \$1.0 million or \$0.2 million, respectively, in Delta Galil's yearly operating income, and a strengthening of the Pound Sterling or Euro would have the opposite effect. Each one percent appreciation of the NIS against the dollar on yearly average would result in a decrease of \$0.5 million in yearly operating income, and a devaluation of the NIS would have the opposite effect. Most of Delta Galil's bank debt is generally denominated in U.S. dollars, and, therefore, is not materially exposed to changes in currency exchange rates.

In addition, Delta Galil hedges part of its exposure to exchange rate fluctuations between the Euro and the Pound Sterling rate and the U.S Dollar by taking part of its bank loans in these currencies.

#### INTEREST RATE RISK

Most of Delta Galil's bank debt bears interest at a variable interest rate linked to the London Inter-Bank Offer Rate, or LIBOR. An increase of 100 basis points, or one percentage point on an annual average basis, in the LIBOR would increase Delta Galil's financing expenses by \$1.6 million per year, based on

amounts outstanding at December 31, 2006. A decrease in the LIBOR would have the opposite effect.

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For further discussion of Delta Galil's use of financial derivatives and instruments in the management of risks relating to currency and interest rate fluctuations, see notes 1(r) and 12 of the notes to Delta Galil's consolidated financial statements included in Item 18 of this annual report.

### ITEM 12: DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not Applicable.

## PART II

### ITEM 13: DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not Applicable.

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

Not Applicable.

### ITEM 15: CONTROLS AND PROCEDURES

Delta Galil's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of Delta Galil's disclosure controls and procedures (as defined in Rule 13(a)-15(e) of the Securities Exchange Act 1934, as amended) as of December 31, 2006 have concluded that, as of such date, Delta Galil's disclosure controls and procedures were effective. Information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to Delta Galil's management, including Delta Galil's chief executive officer and chief financial officer, to allow timely decision regarding required disclosure and is recorded, processed, summarized and reported within the periods specified by the SEC's rules and forms.

There were no changes in Delta Galil's internal controls over financial reporting identified with the evaluation thereof that occurred during the period covered by this annual report that have materially affected, or are reasonable likely to materially affect Delta Galil's internal control over financial reporting.

### ITEM 16A: AUDIT COMMITTEE; FINANCIAL EXPERT

The Board of Directors and the Audit Committee have determined that each of Mr. Amnon Neubach and Mr. Gideon Chitayat is an Audit Committee Financial Expert.

### ITEM 16B: CODE OF ETHICS

Delta Galil has adopted a code of ethics applicable to all employees and directors. A copy is available upon request to the Chief Financial Officer, Delta Galil Industries Ltd., 2 Kaufman Street, Tel-Aviv 68012, Israel.

### ITEM 16C: PRINCIPAL ACCOUNTANT FEES AND SERVICES

Delta Galil paid the following fees for professional services rendered by Kesselman & Kesselman and other members of PricewaterhouseCoopers International Ltd., for the year ended December 31, 2005 and 2006:

|            | 2005      | 2006      |
|------------|-----------|-----------|
| Audit fees | \$520,000 | \$657,000 |
| Tax fees   | 116,000   | 51,000    |
| Other fees | 90,000    | 84,000    |

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|       |                             |                             |
|-------|-----------------------------|-----------------------------|
| Total | -----<br>\$726,000<br>===== | -----<br>\$792,000<br>===== |
|-------|-----------------------------|-----------------------------|

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Audit fees consist of audit work performed in the preparation of financial statements and services that are normally provided in connection with statutory and regulatory filings. Tax fees consist of audit work performed in the preparation of tax returns and other tax planning.

POLICY ON PRE-APPROVAL OF AUDIT AND NON-AUDIT SERVICES

Delta Galil's audit committee charter provides that the audit committee shall approve in advance all audit services and all non-audit services provided by the independent registered public accounting firm based on a policy attached to the charter.

Under the policy, proposed services either (i) may be pre-approved by the audit committee without consideration of specific case-by-case services as "general pre-approval"; or (ii) require the specific pre-approval of the Audit Committee as "specific pre-approval". The appendices to the policy set out the audit, audit-related and tax services that have received the general pre-approval of the audit committee, including those described in the footnotes to the table, above. These services are subject to annual review by the audit committee.

All other audit, audit-related, tax and other services not mentioned in the appendices to the charter must receive a specific pre-approval from the audit committee. Requests or applications to provide services that require specific approval by the audit committee are submitted to the audit committee by the chief executive officer, the chief financial officer and the internal auditor.

ITEM 16D: EXEMPTIONS FROM THE LISTING STANDARDS.

None.

ITEM 16E: PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

PART III

ITEM 17: FINANCIAL STATEMENTS

Not applicable.

ITEM 18: FINANCIAL STATEMENTS

The Consolidated Financial Statements and related notes thereto required by this item are contained on pages F-1 through F-60 hereof.

ITEM 19: EXHIBITS

See "Exhibit Index" and Schedule II to the Consolidated Financial Statements.

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2006

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2006

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The amounts are stated in U.S. dollars (\$) in thousands.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders of

DELTA GALIL INDUSTRIES LTD.

We have audited the consolidated balance sheets of Delta Galil Industries Ltd. (the "Company") and its subsidiaries as of December 31, 2006 and 2005 and the consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other independent registered public accounting firms provide a reasonable basis for our opinion.

In our opinion, based on our audits, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated

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financial position of the Company and its subsidiaries as of December 31, 2006 and 2005, and the consolidated results of their operations, and cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for Share-Based Payments in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) effective January 1, 2006.

Tel-Aviv, Israel  
March 30, 2007

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

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(U.S. dollars in thousands, except earnings (loss) per share)

|   | YEAR ENDED DECEMBER 31 |             |           |
|---|------------------------|-------------|-----------|
|   | 2006                   | 2005        | 2004      |
| NET REVENUES  | \$706,699              | \$684,481   | \$654,269 |
| COST OF REVENUES  | 574,246                | 582,799     | 533,036   |
| GROSS PROFIT  | 132,453                | 101,682     | 121,233   |
| SELLING, MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES | 107,752                | 107,008     | 98,646    |
| AMORTIZATION OF INTANGIBLE ASSET                        | 739                    | 779         |           |
| LOSS (GAIN) ON SALE OF FIXED ASSETS                     | (686)                  | 77          | (922)     |
| IMPAIRMENT OF FIXED ASSETS                              |                        | 7,415       |           |
| RESTRUCTURING EXPENSES                                  | 1,663                  | 9,102       | 1,100     |
| GOODWILL IMPAIRMENT                                     |                        | 5,505       |           |
| OPERATING INCOME (LOSS)                                 | 22,985                 | (28,204)    | 22,409    |
| FINANCIAL EXPENSES - net                                | 13,558                 | 10,218      | 6,231     |
| OTHER INCOME  |                        | (300)       | (958)     |
| INCOME (LOSS) BEFORE TAXES ON INCOME                    | 9,427                  | (38,122)    | 17,136    |
| INCOME TAX BENEFIT (EXPENSE)                            | (5,784)                | 2,302       | (2,846)   |
| SHARE IN LOSSES OF ASSOCIATED COMPANY                   |                        | (35,820)    | 14,290    |
| MINORITY INTERESTS, NET                                 | (495)                  | (500)       | (237)     |
| NET INCOME (LOSS)                                       | \$ 3,148               | \$ (36,347) | \$ 12,685 |
| EARNINGS (LOSS) PER SHARE:                              |                        |             |           |
| Basic   | \$ 0.17                | \$ (1.94)   | \$ 0.69   |
| Diluted   | \$ 0.17                | \$ (1.94)   | \$ 0.67   |
| WEIGHTED AVERAGE NUMBER OF SHARES (IN THOUSANDS) :      |                        |             |           |

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|         |        |        |        |
|---------|--------|--------|--------|
| Basic   | 18,700 | 18,695 | 18,478 |
|         | =====  | =====  | =====  |
| Diluted | 18,742 | 18,695 | 18,834 |
|         | =====  | =====  | =====  |

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

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED BALANCE SHEETS  
(U.S. dollars in thousands)

|  | DECEMBER 31             |           |
|--|-------------------------|-----------|
|  | 2006                    | 2005      |
|  | -----                   | -----     |
| ASSETS   |                         |           |
| CURRENT ASSETS:  |                         |           |
| Cash and cash equivalents  | \$ 10,342               | \$ 14,595 |
| Restricted cash  | 4,000                   |           |
| Accounts receivable:   |                         |           |
| Trade  | 109,710                 | 104,424   |
| Other  | 7,573                   | 13,244    |
| Inventories  | 131,556                 | 147,142   |
| Assets held for sale   | 4,474                   | 7,420     |
| Deferred income taxes  | 4,779                   | 4,726     |
|  | -----                   | -----     |
| Total current assets   | 272,434                 | 291,551   |
|  | -----                   | -----     |
| INVESTMENTS AND LONG-TERM RECEIVABLES:   |                         |           |
| Funds in respect of employee rights upon retirement                                | 7,001                   | 7,021     |
| Long-term receivables and deposits, net of current maturities                      | 1,023                   | 148       |
| Deferred income taxes  | 320                     | 267       |
|  | -----                   | -----     |
|  | 8,344                   | 7,436     |
|  | -----                   | -----     |
| PROPERTY, PLANT AND EQUIPMENT,<br>net of accumulated depreciation and amortization |                         |           |
|  | 99,263                  | 109,131   |
|  | -----                   | -----     |
| GOODWILL   | 57,334                  | 53,689    |
|  | -----                   | -----     |
| INTANGIBLE ASSETS  | 13,259                  | 14,499    |
|  | -----                   | -----     |
| DEFERRED CHARGES, net of accumulated amortization                                  | 228                     | 267       |
|  | -----                   | -----     |
| Total assets   | \$450,862               | \$476,573 |
|  | =====                   | =====     |
| -----  |                         |           |
| D. LAUTMAN   | A. LAHAV                | G. MORAG  |
| CHAIRMAN OF THE BOARD  | CHIEF EXECUTIVE OFFICER | DIRECTOR  |

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

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED BALANCE SHEETS  
(U.S. dollars in thousands)

|  | DECEMBER 31 |           |
|--|-------------|-----------|
|  | 2006        | 2005      |
| LIABILITIES AND SHAREHOLDERS' EQUITY                                       |             |           |
| CURRENT LIABILITIES:   |             |           |
| Short-term bank credit   | \$107,058   | \$ 80,560 |
| Current maturities of long-term bank loans and other liability             | 16,981      | 29,623    |
| Accounts payable and accruals:   |             |           |
| Trade  | 59,038      | 61,255    |
| Other  | 34,504      | 39,164    |
|  | -----       | -----     |
| Total current liabilities  | 217,581     | 210,602   |
|  | -----       | -----     |
| LONG-TERM LIABILITIES:   |             |           |
| Bank loans and other liability, net of current maturities                  | 33,196      | 69,677    |
| Liability for employee rights upon retirement                              | 6,863       | 7,850     |
| Deferred income taxes  | 2,159       | 1,267     |
|  | -----       | -----     |
| Total long-term liabilities  | 42,218      | 78,794    |
|  | -----       | -----     |
| COMMITMENTS AND CONTINGENT LIABILITIES, see note 8                         |             |           |
| Total liabilities  | 259,799     | 289,396   |
|  | -----       | -----     |
| MINORITY INTERESTS   |             |           |
|  | 2,846       | 2,863     |
|  | -----       | -----     |
| SHAREHOLDERS' EQUITY:  |             |           |
| Ordinary shares of NIS 1 par value   |             |           |
| December 31, 2006 and 2005:  |             |           |
| Authorized - 26,000,000 shares;  |             |           |
| Issued - 20,113,711 and 19,947,849 shares                                  |             |           |
| respectively;  |             |           |
| Issued and paid - 19,947,680 and 19,901,967 shares,                        |             |           |
| respectively   | 21,851      | 21,840    |
| Additional paid-in capital   | 101,562     | 100,749   |
| Retained earnings  | 75,781      | 72,633    |
| Accumulated other comprehensive loss                                       | (1,277)     | (1,208)   |
| Treasury shares, at cost (1,206,802 shares, in December 31, 2006 and 2005) | (9,700)     | (9,700)   |
|  | -----       | -----     |
| Total shareholders' equity   | 188,217     | 184,314   |
|  | -----       | -----     |
| Total liabilities and shareholders' equity                                 | \$450,862   | \$476,573 |
|  | =====       | =====     |

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

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DELTA GALIL INDUSTRIES LTD.  
 (An Israeli corporation)  
 CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
 (U.S. dollars in thousands)

|   | SHARE CAPITAL          |              |                                  |                      | ACCUMULATED<br>COMPREHENSIVE<br>INCOME (LOSS) | CURRENCY<br>TRANSLATION<br>ADJUSTMENTS | MINIMUM<br>PENSION<br>LIABILITY |
|---|------------------------|--------------|----------------------------------|----------------------|---|--|---------------------------------|
|   | NUMBER<br>OF<br>SHARES | PAR<br>VALUE | ADDITIONAL<br>PAID-IN<br>CAPITAL | RETAINED<br>EARNINGS |   |  |                                 |
| BALANCE AT JANUARY 1, 2004  | 19,861                 | \$21,830     | \$ 99,735                        | \$104,607            |   |  | \$ (78)                         |
| CHANGES DURING 2004:  |                        |              |                                  |                      |   |  |                                 |
| Net income  |                        |              |                                  | 12,685               |   |  |                                 |
| Net changes in respect of derivative<br>instruments designated as a<br>cash-flow hedge (net of related<br>taxes of \$798,000) |                        |              |                                  |                      |   |  |                                 |
| Differences from translation of<br>foreign currency financial<br>statements   |                        |              |                                  |                      | 45  |  |                                 |
| Additional minimum pension liability<br>adjustment (net of related taxes<br>of \$30,000)                                      |                        |              |                                  |                      |   |  | (45)                            |
| Total comprehensive income  |                        |              |                                  |                      |   |  |                                 |
| Exercise of employee stock options  | 41                     | 10           | 321                              |                      |   |  |                                 |
| Tax benefit in respect of employee<br>stock options exercised   |                        |              | 79                               |                      |   |  |                                 |
| Reissuance of treasury shares on<br>acquisition of Burlen (see note 2a)   |                        |              | 614                              |                      |   |  |                                 |
| Cash dividend (\$0.45 per share)  |                        |              |                                  | (8,312)              |   |  |                                 |
| BALANCE AT DECEMBER 31, 2004  | 19,902                 | \$21,840     | \$100,749                        | \$108,980            | \$45  |  | \$ (83)                         |
| CHANGES DURING 2005:  |                        |              |                                  |                      |   |  |                                 |
| Net loss  |                        |              |                                  | (36,347)             |   |  |                                 |
| Differences from translation of<br>foreign currency financial<br>statements   |                        |              |                                  |                      | (321)   |  |                                 |
| Additional minimum pension liability<br>adjustment (net of related taxes<br>of \$65,000)                                      |                        |              |                                  |                      |   |  | (9)                             |
| Total comprehensive loss  |                        |              |                                  |                      |   |  |                                 |
| BALANCE AT DECEMBER 31, 2005  | 19,902                 | \$21,840     | \$100,749                        | \$ 72,633            | \$ (276)                                      |  | \$ (93)                         |
| CHANGES DURING 2006:  |                        |              |                                  |                      |   |  |                                 |
| Net Income  |                        |              |                                  | 3,148                |   |  |                                 |
| Differences from translation of<br>foreign currency financial   |                        |              |                                  |                      |   |  |                                 |



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|  |        |          |           |           |          |         |
|--|--------|----------|-----------|-----------|----------|---------|
| statements   |        |          |           |           | 118      |         |
| Additional minimum pension liability adjustment (net of related taxes of \$54,000) |        |          |           |           |          | 8       |
| Loss in respect of derivative instruments designated as a cash flow hedge          |        |          |           |           |          |         |
| Total comprehensive income   |        |          |           |           |          |         |
| Stock-based employee compensation  |        |          | 448       |           |          |         |
| Exercise of employee stock options   | 46     | 11       | 365       |           |          |         |
|  | -----  | -----    | -----     | -----     | -----    | -----   |
| BALANCE AT DECEMBER 31, 2006   | 19,948 | \$21,851 | \$101,562 | \$ 75,781 | \$ (158) | \$ (84) |
|  | =====  | =====    | =====     | =====     | =====    | =====   |

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

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(Continued) - 1

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(U.S. dollars in thousands)

|  | YEAR ENDED DECEMBER 31 |             |           |
|--|------------------------|-------------|-----------|
|  | 2006                   | 2005        | 2004      |
|  | -----                  | -----       | -----     |
| CASH FLOWS FROM OPERATING ACTIVITIES:  |                        |             |           |
| Net income (loss)  | \$ 3,148               | \$ (36,347) | \$ 12,000 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                        |             |           |
| Income and expenses not involving cash flows:  |                        |             |           |
| Minority interests net   | 495                    | 500         | 1,000     |
| Share in losses of associated company  |                        | 27          |           |
| Depreciation and amortization  | 15,626                 | 15,811      | 15,000    |
| Impairment of fixed assets   |                        | 7,415       |           |
| Goodwill impairment  |                        | 5,505       |           |
| Deferred income taxes - net  | 839                    | (4,872)     | (1,000)   |
| Restructuring expenses   | 1,156                  | 6,470       | 1,000     |
| Changes in accrued liability for employee rights upon retirement                         | 856                    | (16)        | 1,000     |
| Stock-based employees compensation   | 448                    |             |           |
| Loss (gain) on amounts funded in respect of employee rights upon retirement              | (784)                  | 120         | (1,000)   |
| Capital loss (gain) on sale of fixed assets  | (686)                  | 77          | (1,000)   |
| Capital gain from realization of other investments                                       |                        | (300)       | (1,000)   |
| Erosion (Exchange differences) of long-term receivables                                  | 25                     | 2           |           |
| Erosion of principal of long-term bank loans   |                        |             | (1,000)   |
| Changes in operating assets and liabilities:   |                        |             |           |
| Long term deposit  | (278)                  |             |           |
| Decrease (increase) in accounts receivable   | (741)                  | (2,130)     | 1,000     |

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|  |          |           |        |
|--|----------|-----------|--------|
| Increase (decrease) in accounts payable and accruals | (9,468)  | (17,127)  | 12,    |
| Decrease (increase) in inventories                   | 15,663   | 36,469    | (20,   |
|  | -----    | -----     | -----  |
| Net cash provided by operating activities - forward  | \$26,299 | \$ 11,604 | \$ 22, |
|  | =====    | =====     | =====  |

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(Continued) - 2

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(U.S. dollars in thousands)

|  | YEAR ENDED DECEMBER 31 |           |        |
|--|------------------------|-----------|--------|
|  | 2006                   | 2005      | 2004   |
|  | -----                  | -----     | -----  |
| Brought forward  | \$ 26,299              | \$ 11,604 | \$ 22, |
|  | -----                  | -----     | -----  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                     |                        |           |        |
| Acquisition of subsidiaries (1)                                  |                        | (1,000)   | (56,   |
| Additional payment allocated to goodwill                         | (1,245)                | (1,274)   | (6,    |
| Purchase of property, plant and equipment                        | (5,706)                | (13,034)  | (13,   |
| Investment grants relating to property, plant and equipment      |                        |           | 1,     |
| Other investments  |                        |           |        |
| Amounts carried to intangible assets                             |                        | (500)     |        |
| Proceeds from sale of property, plant and equipment              | 1,274                  | 1,071     | 4,     |
| Proceeds from realization of assets held for sale                | 3,117                  |           |        |
| Proceeds from realization of other investments                   |                        | 300       | 2,     |
| Loans granted to employees                                       | (45)                   | (85)      | (      |
| Collection of employees loans                                    | 111                    | 223       |        |
| Collection of associated company's loan                          |                        | 526       |        |
| Loans granted to associated company                              |                        | (80)      |        |
| Dividend from associated company                                 |                        | 20        |        |
| Restricted cash  | (4,000)                |           |        |
| Investment in long term deposits                                 | (95)                   |           |        |
| Amounts funded in respect of employee rights upon                |                        |           |        |
| Retirement   | (998)                  | (627)     | (      |
| Amounts paid in respect of employee rights upon                  |                        |           |        |
| Retirement   |                        | 13        |        |
|  | -----                  | -----     | -----  |
| Net cash used in investing activities                            | (7,587)                | (14,447)  | (68,   |
|  | -----                  | -----     | -----  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                     |                        |           |        |
| Purchase of long-term bank loans and other long-term liabilities |                        |           | 119,   |
| Repayment of long-term loans and other long-term liabilities     | (49,123)               | (28,079)  | (10,   |
| Dividend to the Company's shareholders                           |                        |           | (8,    |
| Dividend to minority shareholders in a subsidiary                | (512)                  | (1,366)   | (      |
| Short-term bank credit - net                                     | 26,498                 | 24,957    | (48,   |
| Amounts carried to deferred charges                              | (263)                  | (156)     | (      |
| Proceeds from exercise of options                                | 376                    |           |        |
|  | -----                  | -----     | -----  |
| Net cash provided by (used in) financing activities              | (23,024)               | (4,644)   | 50,    |
|  | -----                  | -----     | -----  |

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|  |           |           |        |
|--|-----------|-----------|--------|
| TRANSLATION DIFFERENCES ON CASH AND<br>CASH EQUIVALENTS OF FOREIGN CURRENCY<br>CONSOLIDATED SUBSIDIARY | 59        | (68)      |        |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS   | (4,312)   | (7,555)   | 4,     |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR   | 14,595    | 22,150    | 17,    |
|  | -----     | -----     | -----  |
| CASH AND CASH EQUIVALENTS AT END OF YEAR   | \$ 10,342 | \$ 14,595 | \$ 22, |
|  | =====     | =====     | =====  |

(1) See next page for details.

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(Concluded) - 3

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(U.S. dollars in thousands)

|  | YEAR ENDED DECEMBER 31 |         |          |
|--|------------------------|---------|----------|
|  | 2006                   | 2005    | 2004     |
|  | -----                  | -----   | -----    |
| SUPPLEMENTARY DISCLOSURE OF CASH FLOW<br>INFORMATION - CASH PAID DURING THE<br>YEAR FOR: |                        |         |          |
| Interest   | \$10,039               | \$8,527 | \$ 4,133 |
|  | =====                  | =====   | =====    |
| Income taxes   | \$ 8,793               | \$2,268 | \$ 3,169 |
|  | =====                  | =====   | =====    |

(1) ACQUISITION OF SUBSIDIARIES, SEE ALSO NOTE 2:

|  |  |         |          |
|--|--|---------|----------|
| Assets and liabilities of the subsidiaries upon acquisition: |  |         |          |
| Working capital (excluding cash and cash equivalents)        |  |         | \$29,944 |
| Long-lived assets  |  |         | 9,636    |
| Intangible asset   |  |         | 14,778   |
| Goodwill arising on acquisition                              |  |         | 4,930    |
|  |  |         | -----    |
|  |  |         | 59,288   |
| Reissuance of treasury shares                                |  |         | (2,249)  |
| Amount payable   |  | 1,000   | (1,000)  |
|  |  | -----   | -----    |
| Cash paid - net  |  | \$1,000 | \$56,039 |
|  |  | =====   | =====    |

SUPPLEMENTARY INFORMATION ON INVESTING ACTIVITIES NOT INVOLVING CASH FLOWS:

In 2006, 2005 and 2004, the net changes in outstanding balances of trade payables in respect of the purchase of property, plant and equipment were an increase (decrease) of \$(0.3) million, \$0.6 million and \$ 0.1 million, respectively.

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

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

A. GENERAL:

1) Operations

Delta Galil Industries Ltd. (the "Company") is an Israeli corporation which, together with its subsidiaries (the "Group"), is engaged primarily in manufacturing and marketing of intimate apparel, in seven reportable operating segments - Delta USA, U.S. Upper market, Europe, Socks, Delta marketing Israel, Seam Less and China. As to the Group's segments and principal markets see note 14.

A significant portion of the Group's revenues is derived from three principal customers. See note 11a and 14c.

2) Accounting principles

The consolidated financial statements are prepared in accordance with generally accepted accounting principles ("US GAAP") in the United States of America.

3) Use of estimates in the preparation of financial statements

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

4) Functional currency

The currency of the primary economic environment in which the operations of the Company and most of its subsidiaries are conducted is the U.S. dollar (the "dollar" or "\$"). Since the U.S. dollar is the primary currency in the economic environment in which the Company operates, monetary accounts maintained in currencies other than the dollar are remeasured using the representative foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the rate in effect at the date of the transaction. The effects of foreign currency remeasurement are recorded as financial income or expenses as appropriate.

The functional currencies of a subsidiary is it's local currency (EURO). The financial statements of this subsidiary is included in consolidation based on translation into

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dollars in accordance with the principles set forth in Statement of Financial Accounting Standard ("FAS") No. 52 issued by the FASB: assets and liabilities are translated at year end exchange rate, while operating results items are translated at average exchange rates during the year. Differences resulting from translation are presented in shareholders' equity, under accumulated other comprehensive loss.

### B. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. In these financial statements, "subsidiaries" are companies controlled to the extent of over 50%, the financial statements of which are consolidated with those of the Company. Significant intercompany balances and transactions were eliminated in consolidation. Profits from intercompany sales, not yet realized outside the Group, have also been eliminated.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

##### C. 1. CASH EQUIVALENTS

The Group considers all highly liquid investments, which are comprised of short-term bank deposits (up to three months from date of deposit) that are not restricted as to withdrawal or use, to be cash equivalents.

##### 2. RESTRICTED CASH

The restricted cash relates to a deposit of one of Delta's subsidiaries in connection to it's agreement with banks. The deposit was released during January 2007, see note 7e.

##### D. INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined as follows:

Raw materials and supplies, packaging which is part of the production line and maintenance materials - on the "moving average" basis. Finished products and products in process - direct cost (on the "moving average" basis), labor and an appropriate portion of indirect manufacturing costs.

Inventories are written down for estimated obsolescence, based on assumptions about future demand and market conditions.

The Company adopted the provisions of FASB Statement No. 151, "Inventory Costs," with effect from January 1, 2006. This Statement requires that abnormal idle facility expenses be recognized as current-period charges, and that allocation of

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fixed production overhead costs to inventory be based on normal capacity of the production facility.

The adoption of this standard did not have a material effect on the financial statement of the company.

### E. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, net of accumulated depreciation and of related investment grants in the amount of \$19.2 million and \$ 21.9 million at December 31, 2006 and 2005, respectively.

A fixed asset leased by the Group under capital lease are classified as the Group's asset and included at the present value of the minimum lease payments as determined in the lease agreement.

Depreciation is computed by the straight-line method on the basis of the estimated useful life of the assets, at the following annual rates:

|                                |                         |
|--------------------------------|-------------------------|
| Buildings                      | 2%-7%<br>(mainly 4%)    |
| Machinery and equipment        | 7%-25%<br>(mainly 7%)   |
| Vehicles                       | 15%-20%<br>(mainly 15%) |
| Office furniture and equipment | 6%-25%<br>(mainly 7%)   |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

Long-lived assets to be disposed of by sale are recorded in accordance with the lower of carrying amount or fair value less cost to sell. Costs to sell include incremental direct costs to transact the sale and represent the costs that results directly from and are essential to a sale transaction that would not have been incurred by the Company had the decision to sell not been made. Long-lived assets are not depreciated (amortized) while classified as held for sale.

### F. INTANGIBLE ASSETS

Intangible assets are comprised of customer relationships and exclusive license agreement, and are recorded at cost, less accumulated amortization. Customer relationships are amortized on a straight line basis over their estimated useful life of 20 years, and the exclusive license is amortized on a straight line

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basis over the estimated useful life of 3 years, which is equivalent to the term of the license agreement.

### G. GOODWILL

Under FAS 142 "Goodwill and Other Intangible Assets", goodwill is no longer amortized but tested for impairment at least annually. The Company has selected September 30 of each year as the date on which it performs its annual goodwill impairment test. As a result of this test in 2005, the Company recorded an impairment of \$5.5 million. No impairment resulted from the annual review performed on September 30, 2006.

### H. DEFERRED CHARGES

Deferred charges represent mainly deferred financing charges with respect to bank loans received by the Company which are amortized over the credit period by the effective interest method.

Amortization of deferred charges included among "financial expenses- net" were \$302 thousand, \$ 466 thousand and \$ 353 thousand, for the years ended December 31, 2006, 2005 and 2004, respectively.

### I. IMPAIRMENT IN VALUE OF LONG-LIVED ASSETS AND INTANGIBLE ASSET

Under FAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"), the Company reviews long-lived assets including intangible assets subject to amortization, to be held and used, for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Under FAS 144, if the sum of the expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment loss would be recognized, and the assets are written down to their estimated fair values.

For assets held for sale, impairment losses are recorded when the carrying amount of the asset exceeds fair value less cost to sell.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

### J. DEFERRED INCOME TAXES

Deferred taxes are determined utilizing the asset and liability method, based on the estimated future tax effect differences between the financial accounting and tax bases of assets and liabilities under the applicable tax laws. Deferred income tax provisions and benefits are based on the changes in the deferred tax assets or tax liabilities from period to period.

Valuation allowance is recognized in respect of deferred tax

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assets when it is considered more likely than not that such assets will not be realized.

As stated in note 10a, a plant of an Israeli subsidiary has been granted "approved enterprise" status and, accordingly, upon distribution of dividends by this subsidiary to the Company, such dividends may be subject to tax. In light of the Group's policy not to cause distribution of dividends, which would result in additional tax liabilities, any dividends received from the abovementioned subsidiary will be distributed to the Company's shareholders. Accordingly, no account has been taken of the additional tax in respect of the above dividends.

The Group does not provide for an additional tax liability with respect to the excess of the book value over the tax basis of investments in non-Israeli subsidiaries, as the Company does not expect such temporary differences to be reversed in the foreseeable future.

### K. TREASURY SHARES

Treasury shares held by the Company are presented as a reduction of shareholders' equity, at their cost. The FIFO method was used for the costing of the reissuance of treasury shares, and any resulting gains (net of related tax) are credited to additional paid in capital.

### L. REVENUE RECOGNITION

Revenues from sales of products and supplies are recognized when an arrangement (usually in the form of purchase order) exists, delivery has occurred and title passed to the customer, the Company's price to the customer is fixed or determinable and collectibility is reasonably assured.

Volume discounts due to customers are estimated based on the terms of the agreements with the customers.

A reserve for sales returns is recorded based on historical experience or specific identification of an event necessitating a reserve.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

### M. CONCENTRATION OF CREDIT RISKS - ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Group's cash and cash equivalents as of December 31, 2006 and 2005 were deposited mainly with major banks in United States of America, United Kingdom and Egypt. The Company is of the opinion that the credit risk in respect of these balances is remote.

A large part of the Group's revenues is to 3 principal customers (see also note 14d). The balance receivables from these principal



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customers as of December 31, 2006 and 2005 were \$51,514 thousands and \$ 41,070 thousands, respectively (see also note 11a). The Group does not hold any collateral from these customers; however, based on past experience with those customers and on their credit rating, the Group does not anticipate any difficulties in collecting the above balances. The balance of the item "accounts receivable - trade" is composed of a large number of customers. An appropriate allowance for doubtful accounts is included in the accounts in respect of specific debts doubtful of collection.

The net bad debt income for the years ended December 31, 2006, 2005 and 2004 aggregated \$285 thousand, \$ 143 thousand and \$ 950 thousand, respectively. The net bad debt income include net income that was credited directly to cost and expenses and were not reflected in the allowance of doubtful accounts in the amounts of \$384 thousands, \$469 thousands and \$866 thousands for the years ended December 31, 2006, 2005 and 2004, respectively.

### N. SHIPPING AND HANDLING COSTS

The Group's shipping and handling costs are included under selling and marketing expenses in the consolidated statements of operations. Shipping and handling costs for the years ended December 31, 2006, 2005 and 2004 were approximately \$19 million, \$18 million and \$20 million, respectively.

### O. ADVERTISING COSTS

These costs are expensed as incurred. Advertising costs for the years ended December 31, 2006, 2005 and 2004 were \$2.4 million, \$2.5 million and \$2.1 million, respectively.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

#### P. STOCK BASED COMPENSATION

Prior to January 1, 2006, the company accounted for employees' share-based payment under the intrinsic value model in accordance with Accounting Principles Board Opinion No. 25 - "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations. In accordance with Statement of Financial Accounting Standards No. 123 - "Accounting for Stock-Based Compensation" ("FAS 123"), as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", the Company disclosed pro forma information, assuming the Company had accounted for employees' share-based payments using the fair value-based method defined in FAS 123.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-based Payment" ("FAS 123(R)"). FAS 123(R) supersedes APB 25 and related interpretations and amends Statement of Financial

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Accounting Standards No. 95, "Statement of Cash Flows" ("FAS 95"). FAS 123(R) requires awards classified as equity awards be accounted for using the grant-date fair value method. The fair value of share-based payment transactions is recognized as expense over the requisite service period, net of estimated forfeitures. The Company estimated forfeitures based on historical experience and anticipated future conditions.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107"). SAB 107 provides supplemental implementation guidance on FAS 123(R), including guidance on valuation methods, inventory capitalization of share-based compensation cost, income statement effects, disclosures and other issues. SAB 107 requires share-based payment to be classified in the same expense line items as cash compensation. The Company has applied the provisions of SAB 107 in its adoption of FAS 123(R).

The Company recognize compensation cost for an award with service and performance conditions that has a graded vesting schedule using the accelerated multiple-option approach.

The Company elected to adopt the modified prospective transition method, permitted by FAS 123(R). Under such transition method, FAS 123(R) has been implemented as from the first quarter of 2006 with no restatement of prior periods. The valuation provisions of FAS 123(R) apply to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006 are recognized over the remaining service period using the grant-date fair value of those awards as calculated for pro forma disclosure purposes under FAS 123.

In November 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. FAS 123(R)-3 "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards". The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to FAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee share-based payment, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123(R).

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Upon adoption of SFAS 123R, for the year ended December 31, 2006 no cumulative effect from accounting form accounting change was charged to income.

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The fair value of stock options granted with service and performance conditions was determined using the Black-Scholes valuation model, which is consistent with the valuation techniques previously utilized by the Company for options in footnote disclosures required under SFAS 123, as amended by SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure." Such value is recognized as an expense over the vesting period and in accordance with meeting the performance conditions respectively, net of estimated forfeitures.

Share-based employee compensation cost for the years ended December 31, 2005 and 2004 was determined using the intrinsic value method. The following table provides pro forma financial information as if Share-based employee compensation cost had been computed under FAS 123:

|  | YEAR ENDED DECEMBER 31                  |           |
|--|---|-----------|
|  | 2005                                    | 2004      |
|  | \$ IN THOUSANDS (EXCEPT PER SHARE DATA) |           |
| Net income (loss), as reported   | \$ (36,347)                             | \$ 12,685 |
| Add - stock-based employee compensation expense included in reported net income (loss) net of related tax effect | NIL                                     | NIL       |
| Less - stock-based employee compensation expense determined under fair value method, net of related tax effect   | (331)                                   | (690)     |
| Pro forma net income (loss)  | \$ (36,678)                             | \$ 11,995 |
| Earnings (loss) per share:   |   |           |
| Basic - as reported  | \$ (1.94)                               | \$ 0.69   |
| Basic - pro forma  | \$ (1.96)                               | \$ 0.65   |
| Diluted - as reported  | \$ (1.94)                               | \$ 0.67   |
| Diluted - pro forma  | \$ (1.96)                               | \$ 0.64   |

For the assumptions used in estimating the fair value of the options, see note 9b5.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

Q. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of shares outstanding during the year, net of treasury shares.

Diluted earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of shares outstanding during the year, net of treasury shares, taking into account the potential dilution that could occur upon the exercise of options granted under employee stock option plans, using the treasury stock method. In 2005 all outstanding stock options have been excluded from the calculation of the diluted loss per share since their effect was anti-dilutive.

In 2006, 2,452 thousands options were excluded from the calculation of the diluted loss per share since their effect was anti-dilutive.

R. DERIVATIVES

The Company enters into forward exchange contracts to hedge the cash flows resulting from sales of products, in currencies other than the functional currency. The Company does not hold derivative financial instruments for trading purposes.

Under FAS 133 "Accounting for Derivative and Hedging Activities", all derivatives are recognized on the balance sheet at their fair value. On the date that the Company enters into a derivative contract, it designates the derivative for accounting purposes, as: (1) hedging instrument, or (2) non-hedging instrument.

For derivative financial instruments that are designated and qualify as a cash flow hedge, the effective portions of changes in fair value of the derivative are recorded in other comprehensive income (loss), under unrealized loss from cash flow hedge and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized immediately as income among financial expenses. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognized as income among financial expenses. Cash flows from derivatives that qualify as a cash flow hedge are recognized in the statements of cash flows in the same category as that of the hedged item.

Losses related to the portion of cash flow hedging instruments that were excluded from assessment of hedge effectiveness had an impact on earnings of \$0.6 million for 2004, and the amount of the loss was recorded in financial expenses. There was no impact on earnings for 2005 and 2006.

S. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is composed of net income (loss) and other comprehensive income (loss) which includes gains or losses in respect of derivative instruments designated as cash-flow hedge, differences from translation of foreign currency financial statements and additional minimum pension liability adjustments, net of related taxes.

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(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

#### T. NEWLY ISSUED AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENT

1) In September 2006, the FASB issued FAS 158, "Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans" ("FAS 158"). FAS 158 requires that employers recognize the funded status of their defined benefit pension and other postretirement plans on the consolidated balance sheet. Gains or losses and prior service costs or credits, net of related taxes, that have not been recognized as components of net periodic benefit cost, are recorded as a component of other comprehensive income. The Company adopted the recognition and related disclosure provisions of FAS 158, prospectively, on December 31, 2006, the impact was not material to the Company's financial statements. FAS 158 also requires an entity to measure plan assets and benefit obligation as of the date of its fiscal year-end statement of financial position for fiscal years ending after December 15, 2008. The requirement to measure the Company's plan assets and benefit obligations as of the date of December 31st, which the Company's fiscal year-end, is effective for the Company's fiscal year ending after December 31, 2008. The Company is presently evaluating the impact of the measurement date change.

2) On February 15, 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). Under this Standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS 133 hedge accounting are not met.

SFAS 159 is effective for years beginning after November 15, 2007. Early adoption within 120 days of the beginning of the Company's 2007 fiscal year is permissible, provided the Company has not yet issued interim financial statements for 2007 and has adopted SFAS 157. The Company is currently evaluating the impact of adopting SFAS 159 on its financial position, cash flows, and results of operations.

3) In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 prescribes a comprehensive model for recognizing, measuring and presenting in the financial statements tax positions taken or expected to be taken on a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties and disclosure requirements for uncertain tax positions. FIN 48 is effective for fiscal years beginning on or after December 15, 2006 (January 1, 2007, for the Company). The provisions of FIN 48 shall be applied to all tax positions upon initial

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adoption of this Interpretation. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation.

The cumulative effects, if any, of applying this Interpretation will be recorded as an adjustment to Retained earnings, Goodwill, or Accumulated Gains and (Losses) not Affecting Retained Earnings, as appropriate, as of the beginning of the period of adoption. The Company is currently evaluating the impact of adopting FIN 48 on its financial position, cash flows, and results of operations.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

- 4) In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company adopted the provisions of SAB 108 in connection with the preparation of its financial statements for the year ended December 31, 2006, however adoption of SAB No.108 did not result in any material corrections of the Company's financial statements.
- 5) In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for the Company). Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. The Company is currently evaluating the impact of the provisions of FAS 157 on its financial position and results of operations.
- 6) In June 2006, the Emerging Issues Task Force, reached a consensus on Issue No. 06-03, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross versus Net Presentation)". EITF 06-03 relates to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction. EITF 06-03 states that the presentation of the taxes, either on a gross or net basis,

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is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board Opinion No. 22, "Disclosure of Accounting Policies," if those amounts are significant. EITF 06-03 should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. The Company does not expect that the adoption of EITF 06-03 will have a material effect on its financial position and results of operations.

### U. RECLASSIFICATIONS

Certain figures in respect of prior years have been reclassified to conform with the current year presentation.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 2 - ACQUISITIONS AND OTHER TRANSACTIONS

The acquisitions described bellow have all been accounted for by the purchase method. The consideration for each acquisition was attributed to net assets on the basis of the fair value of assets acquired and liabilities assumed.

#### A. ACQUISITION OF BURLIN INC. (BURLIN) - IN 2004

On December 8, 2004, the Company acquired, through a wholly owned subsidiary all of the shares of Burlin, a privately held U.S. company, which is engaged in the design, development, production, sourcing and marketing of ladies' intimate apparel.

The Burlin acquisition is another step in the Company's strategy to increase its intimate apparel category of the mass market by exploiting the synergies between Burlin's operations and the Company's existing activities. This acquisition is expected to strengthen the Company's position in the U.S. mass market.

The acquisition price amounted to \$ 59.6 million from which \$ 56.4 million was paid in cash (including \$ 8.2 million paid to a bank for discharge of a loan) and \$ 2.2 million in ordinary shares comprised of 215,684 ordinary shares reissued from treasury shares, based on a price per share of \$ 10.43. Acquisition costs accrued to \$ 1.0 million were paid in 2005.

During 2005, the company paid an additional \$1.3 million payment to the selling shareholders with respect to additional cost as it was agreed in the purchase agreement. This payment was recorded as additional goodwill, see also note 5.

In addition, under the agreement the Company may pay additional amounts to the selling shareholders, subject to achieving certain revenues and operating profit targets over a period of 3 years, 2005-2007.

In February 2006, an amendment to the stock purchase agreement was signed which specifies the additional amounts that would be

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paid to the selling shareholders, subject to achieving certain targets over a period of 6 years, 2006-2011 up to a maximum of \$18 million. The purpose of the amendment to the stock purchase agreement was to reflect in it the changes in sales volumes, due to changes in the structure of the company which were contemplated at the time of the original agreement but were not executed by the company. On March 15, 2006 a non-refundable payment of \$1.3 million was made against future consideration with respect to 2007 and 2008 targets. The Company considered this payment as additional purchase cost.

In March 2007, the Company paid additional \$2.4 million to the selling shareholders with respect to 2006 targets, as agreed in the purchase agreement. This amount was recorded on December 31, 2006, as additional goodwill.

After the said contingent consideration, the maximum outstanding contingent consideration amounts to \$14.3 million.

The intangible asset acquired, which amounted to \$ 14.8 million, represents customer relationships and is amortized over a period of 20 years.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 - ACQUISITIONS AND OTHER TRANSACTIONS (continued):

The excess of cost of acquisition over the fair value of net assets, on acquisition date - \$ 3.9 million - was allocated to goodwill and included as part of Delta USA segment. Goodwill and customer relationships are deductible for tax purposes.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

|                                    |          |
|------------------------------------|----------|
| At December 8, 2004 (in thousands) |          |
| Cash and cash equivalents          | \$ 2,605 |
| Account receivable - Trade         | 20,577   |
| Account receivable - Other         | 117      |
| Inventories                        | 19,677   |
| Intangible asset                   | 14,778   |
| Property, plant, and equipment     | 7,805    |
| Goodwill                           | 3,873    |
|                                    | -----    |
| Total assets acquired              | \$69,432 |
|                                    | =====    |
| Short-term bank credit             | 3,038    |
| Accounts payable - Trade           | 4,341    |
| Accounts payable - Other           | 2,452    |
|                                    | -----    |
| Net assets acquired                | \$59,601 |
|                                    | =====    |

B. ACQUISITION OF A MANUFACTURING PLANT IN THAILAND (THAILAND) - IN



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2004

In December 2004 the Company acquired a manufacturing facility in Thailand for a total consideration of \$2.4 million. From the said amount \$0.9 million was paid for the shares and \$0.8 million was paid to settle debt of the former shareholders. In addition, the Company assumed bank debt of \$0.7 million. The acquired manufacturing facility in Thailand constitutes a "business" under EITF 98-3 - "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business".

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 - ACQUISITIONS AND OTHER TRANSACTIONS (continued):

The main strategy behind the Thailand plant acquisition is to reduce the sewing cost.

The excess of cost of acquisition over the fair value of net assets on acquisition date of approximately - \$1.0 million - was allocated to goodwill.

At December 31, 2004 (in thousands)

|                                |         |
|--------------------------------|---------|
| Cash and cash equivalent       | \$ 61   |
| Account receivable - Trade     | 1,025   |
| Account receivable - Other     | 34      |
| Inventories                    | 1,381   |
| Property, plant, and equipment | 1,831   |
| Goodwill                       | 1,057   |
|                                | -----   |
| Total assets acquired          | \$5,389 |
|                                | -----   |
| Short-term bank credit         | 601     |
| Accounts payable - Trade       | 528     |
| Accounts payable - Other       | 1,776   |
| Long term debt                 | 131     |
|                                | -----   |
| Net assets acquired            | \$2,353 |
|                                | =====   |

- C. Hereafter are certain unaudited pro forma combined income data which assumes that the acquisition of Burlen had occurred on January 1, 2004. The unaudited pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisition of Burlen occurred as of January 1, 2004 nor is it necessarily indicative of future results.

YEAR ENDED  
DECEMBER 31

-----  
2004  
-----

IN THOUSANDS

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|                             | (EXCEPT EARNINGS<br>PER SHARE) |
|-----------------------------|--------------------------------|
|                             | -----<br>(UNAUDITED)<br>-----  |
| Net Revenues                | \$763,375<br>=====             |
| Net Income                  | \$ 19,853<br>=====             |
| Earning per share - Basic   | \$ 1.06<br>=====               |
| Earning per share - Diluted | \$ 1.04<br>=====               |

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 - LONG-TERM RECEIVABLES AND DEPOSITS

COMPOSITION:

|  | DECEMBER 31  |       |
|--|--------------|-------|
|  | 2006         | 2005  |
|  | -----        | ----- |
|  | IN THOUSANDS |       |
|  | -----        | ----- |
| Long term loans to employees (*)             | \$ 37        | \$148 |
| Long term Deposits and prepaid expenses (**) | 798          |       |
| Long term trade receivable (***)             | 188          |       |
|  | -----        | ----- |
|  | \$1,023      | \$148 |
|  | =====        | ===== |

(\*) Represent long-term loans to employees - mainly linked to the Israeli consumer price index ("CPI") and bearing interest at the rate of 4%.

(\*\*) Deposits are composed mainly for vehicles under operational lease for a period of 3 years, and for offices and other rented facilities over the rental period.

(\*\*\*) Will be paid in 9 equal yearly installments.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT:

A. Composition of property, plant and equipment, grouped by major classifications, is as follows:

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|  | DECEMBER 31  |           |
|--|--------------|-----------|
|  | 2006         | 2005      |
|  | IN THOUSANDS |           |
| Land and buildings, see (*) and b                                      | \$ 33,143    | \$ 32,205 |
| Machinery and equipment  | 110,421      | 112,507   |
| Vehicles, office furniture and equipment<br>and leasehold improvements | 44,779       | 48,205    |
|  | 188,343      | 192,917   |
| Less - accumulated depreciation and<br>amortization                    | (89,080)     | (83,786)  |
|  | \$ 99,263    | \$109,131 |
|  | =====        | =====     |

(\*) Including building leased under capital lease see note 1e:

|                                 |          |          |
|---------------------------------|----------|----------|
| Cost                            | \$ 1,414 | \$ 1,414 |
| Less - accumulated depreciation | 593      | 501      |
|                                 | \$ 821   | \$ 913   |
|                                 | =====    | =====    |

B. LAND AND BUILDINGS

Part of the buildings of the Company stand on land leased from the Israel Lands Administration for periods expiring in the years 2016-2037. The leasehold rights have not yet been registered in the Land Registry.

Investment projects of the Company and its subsidiary have been approved by the Israeli Investment Center, under the Law for the Encouragement of Capital Investment, 1959. The Company has filed final reports to the Investment Center during 2005.

C. Depreciation and amortization in respect of property, plant and equipment totaled \$14.1, \$14.6 and \$14.8 million in the years ended December 31, 2006, 2005 and 2004 (excluding impairment of assets see f. below and impairment of assets relating to restructuring, see note 11e).

D. As to pledges on assets, see notes 7d and 10a.

E. ASSETS HELD FOR SALE

In connection with the 2005 restructuring plan, management committed to a plan to sell certain real estate properties located in Israel, Scotland, Hungary and the US. As a result, these assets were classified at carrying value of \$7.4 million as current assets under the category of "assets held for sale" on the balance sheet as at December 31, 2005. During 2006 the Company sold the properties in Ireland, Scotland and certain assets in the US, resulting in net gain on sale of assets of \$170 thousand in 2006. The remaining assets, which have a carrying value of \$4.5 million, were not sold in 2006 however the assets are actively being marketed for sale in 2007. The Company estimates that the rest of the assets will be disposed of during 2007. See also note 14b, for segmental data.

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During January 2007 the Company sold its asset held for sale in the US.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT (continued):

- F. During 2005, as a result of the restructuring plan, following the change in operation in various divisions and the erosion in profitability, the Company tested the carrying amount of its long-lived assets and as a result recorded a total impairment of \$9.8 million, of which \$2.4 is included among restructuring expenses and \$7.4 million is included among impairment of assets.

The long-lived assets which were impaired include mainly machinery and equipment in the fabric and Seam-Less facilities in Israel, and leasehold improvements in real-estate which would be abandoned as part of the Company's plan to consolidate most of its premises in Carmiel, Israel.

During 2006, as a result of the restructuring plan in the Far East which included the Company's decision to discontinue sewing operations in China, the Company tested the carrying value of long lived assets and as a result recorded a total impairment of \$1.2 million, which is included among restructuring expenses. The long lived assets which were impaired were mainly lease hold improvements. See also note 14, for segment information.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 - INTANGIBLE ASSETS AND GOODWILL

A. INTANGIBLE ASSETS

The intangible assets include: a) customer relationship at the amount of \$ 14.8 million, which is amortized over 20 years period, see also note 2a, the amortized customer relationship as of December 31, 2006 and 2005 amounts to \$13.3 million and \$14 million, respectively; b) exclusive license as of December 31, 2006 and 2005 at the amount of Nil and \$ 0.5 million, respectively (as to the write-down during 2006, see below).

Aggregate amortization expenses for the years ended December 31, 2006, 2005 and 2004 were \$0.7 million, \$0.7 million and NIL respectively. Estimated amortization expenses over the years 2007-2011, is \$0.7 million per year, and \$9.6 million in aggregate for the years 2012-2024.

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At the end of 2006, an exclusive license agreement with Levi's was terminated, as a result of Levi's decision to cease its Jeans operations in Europe. In connection with the early termination of the license, the Company received a \$0.3 million as a termination payment from Levi's. The payment received was recorded against the carrying value of the license intangible of \$0.3 million.

### B. GOODWILL

The Company has selected September 30 of each year as the date on which it performs its annual goodwill impairment test. As a result of this test in 2005, the Company recorded an impairment of \$5.5 million.

Financial results of the U.S Upper Market and Socks segments and the expected results of these segments have been reevaluated during the goodwill impairment test. The erosion in selling prices, due to the changes in the business environment, indicated a decrease in the fair value of the reporting unit, which resulted in the above mentioned impairment.

The fair value of these reporting units were estimated using the multiple method. No impairment resulted from the annual review, performed in September 30, 2006.

Changes in the carrying amount of goodwill for the two years ended December 31 2006, are as follows:

|  | YEAR ENDED<br>DECEMBER 31, 2006 |         |          |
|--|---------------------------------|---------|----------|
|  | -----<br>IN THOUSANDS<br>-----  |         |          |
|  | DELTA<br>USA                    | EUROPE  | TOTAL    |
|  | -----                           | -----   | -----    |
| Goodwill at beginning of year                | \$51,879                        | \$1,810 | \$53,689 |
| Changes during the year:                     |                                 |         |          |
| Adjustment to purchase<br>price, see note 2a | 3,645                           |         | 3,645    |
|  | -----                           | -----   | -----    |
| Goodwill at end of year                      | \$55,524                        | \$1,810 | \$57,334 |
|  | =====                           | =====   | =====    |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 - INTANGIBLE ASSETS AND GOODWILL (continue):

|  | YEAR ENDED DECEMBER 31, 2005   |
|--|--------------------------------|
|  | -----<br>IN THOUSANDS<br>----- |

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|  | DELTA<br>USA | US UPPER<br>MARKET | EUROPE  | SOCKS    | TOTAL    |
|--|--------------|--------------------|---------|----------|----------|
|  | -----        | -----              | -----   | -----    | -----    |
| Goodwill at beginning of year                | \$50,605     | \$ 2,119           | \$1,810 | \$ 3,386 | \$57,920 |
| Changes during the year:                     |              |                    |         |          |          |
| Impairment of Goodwill                       |              | (2,119)            |         | (3,386)  | (5,505)  |
| Adjustment to purchase<br>price, see note 2a | 1,274        |                    |         |          | 1,274    |
|  | -----        | -----              | -----   | -----    | -----    |
| Goodwill at end of year                      | \$51,879     | -,-                | \$1,810 | -,-      | \$53,689 |
|  | =====        | =====              | =====   | =====    | =====    |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 - EMPLOYEE RIGHTS UPON RETIREMENT:

- A. Employees related obligations are composed as follows:

|   | DECEMBER 31  |         |
|---|--------------|---------|
|   | 2006         | 2005    |
|   | -----        | -----   |
|   | IN THOUSANDS |         |
|   | -----        | -----   |
| Accrued severance pay                             | \$6,826      | \$6,360 |
| Obligation in respect of defined<br>benefit plans | 37           | 1,490   |
|   | -----        | -----   |
|   | \$6,863      | \$7,850 |
|   | =====        | =====   |

As of December 31, 2006 and 2005, the Group had deposits of \$7 million and \$5.8 million, respectively, with funds managed by major Israeli insurance companies, which are earmarked by management to cover the severance pay liability in respect of Israeli employees. The amounts deposited with insurance companies are marked to market at each balance sheet date, with gains and losses recorded in the statement of operations as part of the financial expenses. Under FAS No. 132, "Employers Disclosures About Pensions and Other Post Retirement Benefits", such deposits are not considered to be "plan assets".

Costs of pension and severance pay charged to income in the years ended December 31, 2006, 2005 and 2004 were \$5.8 million, \$6.2 million and \$7.5 million respectively (in 2006, 2005 and 2004, excluding \$507 thousand, \$5,894 thousand and \$190 thousand, respectively, relating to the termination of employment, which were charged to restructuring expenses, see note 11e).

The accumulated comprehensive loss from minimum pension liability for the years ended December 31, 2006, 2005 and 2004, is net of related taxes of \$506 thousand, \$560 thousand and 495 thousand,

respectively.

The profit (loss) from deposits in respect of severance pay were \$784 thousand, \$(120) thousand and \$416 thousand in the years ended December 31, 2006, 2005 and 2004, respectively.

The main terms of the various arrangements with employees are described in b. below. Further details relating to defined benefit plans, as required by FAS 132, are presented in b and c below.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 - EMPLOYEE RIGHTS UPON RETIREMENT (continued):

B. TERMS OF ARRANGEMENTS:

1) The Company and Israeli subsidiaries

Israeli law generally requires payment of severance pay and/or pensions upon dismissal of an employee or upon termination of employment in certain other circumstances. The following principal plans relate to employee rights upon retirement, as applicable to Israeli companies in the Group:

Pension plans for the majority of the Group's employees - under collective labor agreements, these external pension plans cover the severance pay liability. The pension and severance pay liabilities covered by these plans are not reflected in the financial statements as the pension and severance pay risks have been irrevocably transferred to the pension funds.

- a) Insurance policies for employees in managerial positions - these policies provide coverage for severance pay and pension liabilities of managerial personnel. Under labor agreements these insurance policies are, subject to certain limitations, the property of the employees.
- b) Severance pay liabilities not covered by the pension funds are fully provided for in these consolidated financial statements, as if it was payable at each balance sheet date on an undiscounted basis, based upon the number of years of service and the most recent monthly salary of the Group's employees in Israel.

2) Non-Israeli subsidiary

A U.S. subsidiary provides various defined benefit pension plans to its employees, see c below.

At December 31, 2006, the assets of the defined benefit pension plan are primarily invested in group annuity contracts with an insurance Company. The plan was frozen

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effective January 1996.

The Company maintains two defined contribution 401(k) plans. Contributions are based on a percentage of annual salaries. The Company generally matches 50% of each participant's pretax contribution up to 4% of the participant's annual compensation, depending on the plan. The Company's matching contribution was \$239 thousand and \$308 thousand for the years ended December 31, 2006 and 2005, respectively.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 - EMPLOYEE RIGHTS UPON RETIREMENT (continued):

C. CERTAIN DETAILS RELATING TO DEFINED BENEFIT PLANS:

|  | 2006         | 2005     |
|--|--------------|----------|
|  | -----        | -----    |
|  | IN THOUSANDS |          |
|  | -----        | -----    |
| CHANGE IN BENEFIT OBLIGATION:                  |              |          |
| Benefit obligation at beginning of year        | \$ 3,330     | \$ 3,140 |
| Interest cost                                  | 169          | 178      |
| Actuarial (gain) loss                          | (196)        | 204      |
| Benefit paid                                   | (198)        | (192)    |
|  | -----        | -----    |
| Benefit obligation at end of year              | \$ 3,105     | \$ 3,330 |
|  | -----        | -----    |
| CHANGE IN PLAN ASSETS:                         |              |          |
| Fair value of plan assets at beginning of year | \$ 3,088     | \$ 2,999 |
| Actual return on plan assets                   | 90           | 188      |
| Employer contribution                          | 125          | 125      |
| Benefit paid, including plan expenses          | (235)        | (223)    |
|  | -----        | -----    |
| Fair value of plan assets at end of year       | \$ 3,068     | \$ 3,089 |
|  | -----        | -----    |
| RECONCILIATION OF FUNDED STATUS:               |              |          |
| Funded status (carryforward obligations)       | \$ (37)      | \$ (241) |
| Unrecognized net actuarial loss                | 1,346        | 1,490    |
| Adjustment to recognize minimum liability      | (1,346)      | (1,490)  |
|  | -----        | -----    |
| Accrued pension cost                           | \$ (37)      | \$ (241) |
|  | =====        | =====    |

The estimated future benefit payments in each of the five years subsequent to 2006 are as follows (in thousands):

|           |       |
|-----------|-------|
| 2007      | 178   |
| 2008      | 181   |
| 2009      | 192   |
| 2010      | 195   |
| 2011      | 196   |
| 2012-2016 | 1,009 |
|           | ----- |
|           | 1,951 |



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The actuarial assumptions used to determine the benefit obligations and costs are as follows:

|                                | 2006  | 2005  | 2004  |
|--------------------------------|-------|-------|-------|
|                                | ----- | ----- | ----- |
| WEIGHTED AVERAGE ASSUMPTIONS   |       |       |       |
| AT END OF YEAR:                |       |       |       |
| Discount rate                  | 5.41% | 5.41% | 5.75% |
| Expected return on plan assets | 6.00% | 6.00% | 6.25% |
| Interest rate                  | 5.72% | N/A   | N/A   |
| Rate of compensation increase  | N/A   | N/A   | N/A   |

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 - EMPLOYEE RIGHTS UPON RETIREMENT (continued):

ADDITIONAL INFORMATION

Increase (decrease) in minimum liability included other comprehensive income, net of tax, \$88 thousand and \$99 thousand in year 2006 and 2005 respectively.

Information for a pension plan with an accumulated benefit obligation in excess of plan assets is as follows (in thousands):

|                              | 2006    | 2005    |
|------------------------------|---------|---------|
|                              | -----   | -----   |
| Projected benefit obligation | \$3,105 | \$3,330 |
| Fair value of plan assets    | 3,068   | 3,089   |

Contributions totaling \$125 thousand were made in the years ended December 31, 2006 and 2005. For the year ended December 31, 2007, the Company anticipates satisfying any minimum funding requirements by making contributions of \$178 thousand.

The consolidated components of net periodic benefits costs are as follows:

|                                | YEAR ENDED<br>DECEMBER 31 |        |        |
|--------------------------------|---------------------------|--------|--------|
|                                | 2006                      | 2005   | 2004   |
|                                | -----                     | -----  | -----  |
|                                | IN THOUSANDS              |        |        |
|                                | -----                     | -----  | -----  |
| Interest cost                  | \$ 169                    | \$ 178 | \$ 179 |
| Expected return on plan assets | (179)                     | (182)  | (122)  |
| Recognized net actuarial cost  | 74                        | 72     | 10     |
|                                | -----                     | -----  | -----  |
|                                | \$ 64                     | \$ 68  | \$ 67  |
|                                | =====                     | =====  | =====  |

At December 31, 2006 and 2005, the assets of the defined benefit plan are primarily invested in group annuity contracts with an insurance Company.

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The Company recorded the minimum pension liability required by the provisions of Financial Accounting Standards Board Statement No. 87, Employers Accounting for Pensions.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 - EMPLOYEE RIGHTS UPON RETIREMENT (continued):

D. CASH FLOWS INFORMATION REGARDING THE COMPANY'S LIABILITY FOR EMPLOYEE RIGHTS UPON RETIREMENT:

1. The Company expects to contribute in 2007, \$600 thousand to insurance companies and \$NIL thousand to contribution plans.
2. The Company expects to pay the following future benefits to its Israeli employees upon their normal retirement age:

|                 | SEVERANCE PAY BENEFITS |
|-----------------|------------------------|
|                 | -----                  |
|                 | IN THOUSANDS           |
|                 | -----                  |
| 2007            | 297                    |
| 2008            | 261                    |
| 2009            | 652                    |
| 2010            | 167                    |
| 2011            | 247                    |
| Years 2012-2016 | 879                    |
|                 | -----                  |
|                 | 2,503                  |
|                 | =====                  |

These amounts, as they relate to the Israeli subsidiaries were determined based on the employees' current salary rates and the number of service years that will be accumulated upon their retirement date. These amounts do not include additional amounts that might be paid to employees that will cease working with the Company before their normal retirement age.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 - LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY:

A. COMPOSITION:

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|   | WEIGHTED<br>AVERAGE<br>INTEREST RATE | DECEMBER 31,<br>2006 | DECEMBER 31,<br>2006 |
|---|--------------------------------------|----------------------|----------------------|
|   | %                                    |                      | IN THOUSANDS         |
| Bank loans - in dollars   | 6.6                                  |                      | \$49,289             |
| Other liability - obligation under capital lease,<br>see note 1e and c below - in dollars | 8.6                                  |                      | 888                  |
|   |                                      |                      | 50,177               |
| Less - current maturities   |                                      |                      | (*)16,981            |
|   |                                      |                      | \$33,196             |

B. TOTAL LIABILITIES (NET OF CURRENT MATURITIES) MATURE IN THE FOLLOWING YEARS AFTER BALANCE SHEET DATES:

|                          | DECEMBER 31, 2006 |
|--------------------------|-------------------|
|                          | IN THOUSANDS      |
| 2008                     | (*) \$16,987      |
| 2009                     | (*) 15,587        |
| 2010                     | 105               |
| 2011                     | 114               |
| 2012 year and thereafter | 403               |
|                          | \$33,196          |

(\*) In January 2007 the Company settled \$22.5 million of long term loans in the U.S., see amendment No.4 to the credit agreement in e3 below.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 - LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY (continued):

C. A subsidiary of the Company has entered into capital lease agreements for a building it uses; the lease will expire in 2014.

Following are the future minimum lease payments, by years, under capital lease and the present value of the net minimum lease payments as of December 31, 2006:

IN  
THOUSANDS  
-----

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|                                     |        |
|-------------------------------------|--------|
| 2007 - current maturities           | \$ 158 |
| 2008                                | 158    |
| 2009                                | 158    |
| 2010                                | 158    |
| 2011                                | 158    |
| 2012 and thereafter                 | 474    |
|                                     | -----  |
|                                     | 1,264  |
| Less - amount representing interest | 376    |
|                                     | -----  |
|                                     | \$ 888 |
|                                     | =====  |

- D. Liabilities to banks are fully secured by floating charges in an unlimited amount on all the assets and rights of the Company and the assets of part of its subsidiaries.
- E. Delta Galil USA Inc., a subsidiary of the Company is a party to a credit agreement, as amended on December 9, 2004, with Bank Leumi U.S.A and Bank Hapoalim B.M. Borrowings under the credit agreement are secured by substantially all of the assets of the subsidiary. As of December 31, 2006 the credit agreement provided for up to \$22.5 million long terms loans, and up to \$60 million are short term loans. The loan bears interest at a variable rate that is linked to the Libor. As of December 31, 2006, the interest rate on the long term loan was 7.0% and on the short-term credit was 6.7%. As of December 31, 2006 the unutilized credit line was \$15.0 million.

The credit agreement included covenants based on (1) the ratio of Delta Galil USA's earnings before interest, taxes, depreciation and amortization, or EBITDA, to fixed charges; (2) the ratio of net worth to total assets of Delta Galil USA; and (3) the ratio of the sum of Delta Galil USA's (a) loans (b) letters of credit, and (c) acceptances to EBITDA.

Delta Galil USA did not satisfy the covenants as in effect prior to the amendment in the agreement, for the years ended December 31, 2006 and 2005. Amendment no. 4 from January 2007 replaced the covenants as of December 31, 2006 and for 2007. Management believed that Delta Galil USA will satisfy the covenants as included in the new amendment.

2006 Amendment

Delta Galil USA and the banks amended the credit agreement in January 2006 and in May 2006. The material changes contained in those amendments were the following: A prepayment of \$25 million of the principal amount of the long term loan; a reduction in the quarterly payment on the long term loan from \$3.5 million to \$1.9 million; an extension of the expiration date of the revolving loan facility from January 15, 2006 to January 31, 2007; a deposit of \$4 million with Bank Leumi USA and a pledge of that deposit to the banks, an increase of 0.25% in the interest rate; and a change of the covenant mentioned above as follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 7 - LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY (continued):

1. The ratio of Delta Galil USA's EBITDA to fixed charges, as defined in the credit agreement, may not be below 1 to 1 for each three -month period ending June 30, September 30, and December 31, 2006, with such ratio rising to 1.5 to 1 for the twelve months ending March 31, June 30, September 30, and December 31, 2007, and 1.6 to 1 for the twelve months ending March 31, June 30, September 30, and December 31 2008 and 2009;
2. The ratio of net worth to total assets of Delta Galil USA may not be below 0.25 to 1 for the twelve months ending March 31, 2006 and June 30, 2006, and a ratio of 0.28 to 1 for the twelve months ending September 30, 2006 and for the twelve-month period ending December 31, 2006, with such ratio rising to 0.4 to 1 for the twelve months ending March 31, 2007 and for the end of each subsequent quarter until maturity;
3. The ratio of the sum of Delta Galil's (a) loans (b) letters of credit, and (c) acceptances (or, collectively, debt) to EBITDA may not exceed 6.70 to 1 for the twelve months ending March 31, 2006; 5.70 to 1 for the twelve months ending June 30, 2006, and 4 to 1 for the twelve months ending each of September 30, 2006 and December 31, 2006, with such ratio rising to 3.5 to 1 for the twelve months ending March 31, June 30, September 30, and December 31, 2007, 3.0 to 1 for the twelve months ending March 31, 2008 and for each twelve months period ending at the end of each subsequent quarter until maturity.

In May 2006, Delta Galil USA and the banks further amended the credit agreement to revise, among other things, the prepayment terms of the term loan.

2007 Amendment No. 4

In January 2007, Delta Galil USA and the banks entered into Amendment no. 4 to the credit agreement. The material changes contained in this amendment are the following:

A prepayment of the outstanding long term loan in the principal amount of \$22.5 million; An increase of the Short Term revolving loan from \$60 million to \$90 million. a change to the term loan interest rate to LIBOR + 1.5%; an extension of the expiration date of the revolving loan facility from January 31, 2007 to January 31, 2008; a subordination of the Company's loan to Delta Galil USA in the amount of \$20 million for a period ending December 1, 2009; a conversion of \$5 million of the outstanding Company's loan to Delta Galil USA into equity of Delta Galil USA.; a release of the \$4 million deposit with Bank Leumi USA; a change to the financial covenants as follows:

1. The ratio of net worth to total assets of Delta Galil USA may not be below a ratio of 0.28 to 1 as of December 31, 2006 and as of March 31, June 30 and September 30, 2007, and a ratio of 0.3 to 1 as of

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December 31, 2007;

2. The net worth of Delta Galil USA may not be less than \$60 million as of December 31, 2006 and as of March 31, June 30 and September 30, 2007, and \$65 million as of December 31, 2007; and
3. For the twelve month period ending December 31, 2006, and for the rolling twelve month period ending on each subsequent fiscal quarter thereafter, Delta Galil USA shall have a profit of at least \$1.00.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES:

A. COMMITMENTS

The Company and its subsidiaries lease 27 facilities under operating leases. The leases (including extension options) for 20 facilities expire on various dates between 2008 and 2029 and the remaining leases expired in 2007. The Company intends to renew some of these leases. The minimum future annual lease payment over each of the years 2007 to 2011 will amount to \$8.7, \$8.1, \$7.2, \$3.8 and \$2.8 million, respectively. In the period from 2012 to the end of the lease periods, the cumulative lease payments will amount to \$17.8 million. The lease expenses for each of the years 2006, 2005 and 2004 were \$8.5 million, \$9.3 million, \$8.6 million respectively.

- B. The Company entered into agreements which granted the Company rights to market certain of its products under brand names owned by other parties. Royalties under these agreements are calculated as a percentage of the sales. The royalties rate range from 3% to 15% of sales, the minimum future guaranteed royalties over the years 2007 to 2010 will amount to \$4.3, \$2.1, \$2.0 and \$1.5 million, respectively.

C. CONTINGENT LIABILITIES - GUARANTEES

The Company and part of its subsidiaries signed a guarantee, each for other, which is unlimited in amount to all of the group's liabilities.

- D. As to contingent consideration, see note 2a.

NOTE 9 - SHAREHOLDERS' EQUITY:

A. SHARE CAPITAL:

- 1) The Company's shares are traded on the Tel-Aviv Stock Exchange ("TASE") and in the form of American Depositary Shares ("ADS's"), each of which represents one ordinary share, on the Nasdaq National Market in the United States. On December 31, 2006, the closing price per ADS on Nasdaq

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was \$9.08; the shares were quoted on the TASE on that date at NIS 36.81 (\$8.7).

- 2) On December 2004, the Company reissued 215,684 treasury shares as part of the proceeds paid to the selling shareholders of Burlen, see note 2a.
- 3) As of December 31, 2006 and 2005, the balance of shares issued by the Company for the purpose of future exercise of employee stock options, which is held by a trustee company are 166,031 and 45,882 respectively.
- 4) The shares held by the Company ("treasury shares") have no voting rights and are not entitled to receive dividends.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9 - SHAREHOLDERS' EQUITY (continued):

B. STOCK OPTION PLANS FOR EMPLOYEE:

The company Company adopted various option plans subject to service conditions and performance conditions:

1. Stock Option plans under subject to service conditions:

- a. On June 4, 2000, the Company's Board of Directors approved an employee stock option plan for the grant, without consideration, of 809,000 options (including 100,000 options to its former CEO), exercisable of 809,000 ordinary shares of NIS 1 par value of the Company, to 70 senior employees of the Group ("the optionees"). All the options were granted on August 6, 2000. The exercise price of each option is \$ 21.07, based on the quoted price of the Company's shares on the last day of trade prior to the Board of Directors' resolution.

The options vested in four equal batches and as of December 31, 2006, all are fully vested. The options are exercisable over a three years period, commencing one year after the vesting date of each batch.

Any option not exercised within the said three years will expire. The options expire over the years 2005-2008.

- b. On October 23, 2002, the Company's Board of Directors approved an employee stock option plan for the grant, without consideration, of 1,100,000 options (including 100,000 options to its Former CEO), exercisable in purchase of 1,100,000 ordinary shares of NIS 1 par value of the Company. The exercise price of each option is the higher of the quoted price of the Company's shares on the grant day or \$ 9.

On November 22, 2002, the Company granted 1,004,500 options

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to 97 senior employees of the Group (including 100,000 options to the Former CEO) at an exercise price of \$ 9. The options vest in four equal batches and as of December 31, 2006 all are fully vested. The options are exercisable over a three-year period, commencing one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batch.

In May 2003 the Company granted 30,000 options to three employees of the Group at an exercise price of \$10.76. The first three batches vested in May 2004, 2005 and 2006 respectively and the fourth batch will vest in May 2007. In March and in August 2004 the Company granted 80,000 and 30,000 options respectively, to six and one employees of the Group, respectively, at an exercise price of \$ 15.35 and \$ 12.74, respectively. The first, second, third and fourth batches will vest in March and August 2005, 2006, 2007 and 2008 respectively. The options are exercisable over a three-year period, commencing one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batch.

At December 31, 2006 112,250 options remain available for grant under this plan.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 9 - SHAREHOLDERS' EQUITY (continued):

- c. In May 2006 the company's Board of Directors approved two option plans, one for Israeli and other non-U.S. employees and another plan for U.S. employees. A total of up to 1,400,000 options, representing approximately 6.5% of Delta Galil's issued capital on a fully diluted basis, may be issued under the plans. Of such number, 1,100,000 options are issuable under the plan for Israeli and other non-U.S. employees and 300,000 options are issuable under the plan for U.S. employees. Each option may be exercised for one ordinary share NIS 1 par value of the Company pursuant to terms of the relevant option plan.

A total of 1,018,018 options were granted subject to service condition. The exercise price of 568,016 options granted in May 2006 is \$8.43. The exercise price of 425,000 options granted in June 7, 2006 is \$7.26, and the exercise price of 25,002 options granted on June 25, 2006 is \$7.59. Of the 1,018,018 options granted, 489,014 were granted to executive officers.

On September 21, 2006 the Company granted 50,000 options to an employee of the group at an exercise price of \$9.20. The options are vested over a three years period, subject to the same terms as defined in the option plan from May 2006.



The options vest and are exercisable as follows:

First quarter- vest on the first anniversary of the Date of Grant and are exercisable for three years from the second anniversary of the Date of Grant.

Second quarter - vest on the second anniversary of the Date of Grant and are exercisable for three years thereafter

Third quarter - vest on the third anniversary of the Date of Grant and are exercisable for three years thereafter

Final quarter - vest on the fourth anniversary of the Date of Grant and are exercisable for three years thereafter.

As of December 31, 2006, 72,286 options granted to certain employees who left the Company, were forfeited.

As of December 31, 2006 and 197,268 options remain available for grant under the plan from May 2006.

- d. The weighted-average grant-date fair value of options granted during the years 2006, 2005, and 2004 was \$1,900, \$NIL, and \$420 thousands, respectively. The fair value of each option granted is estimated on the date of grant using the Black & Scholes option-pricing model, with the following weighted average assumptions:

|                          | 2006   | 2004   |
|--------------------------|--------|--------|
|                          | -----  | -----  |
| Dividend yield           | 4.0%   | 3.5%   |
|                          | =====  | =====  |
| Expected volatility (*)  | 31.00% | 28.00% |
|                          | =====  | =====  |
| Risk-free interest rate  | 5%     | 4%     |
|                          | =====  | =====  |
| Expected life - in years | 4.38   | 4.25   |
|                          | =====  | =====  |

(\*) Based on the historical volatility

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9 - SHAREHOLDERS' EQUITY (continued):

The total unrecognized compensation cost on employee stock options at December 31, 2006 is \$1,497 thousand (net of forfeiture rate), and it is expected to be recognized over a weighted average period of 3.5 years.

The total cash received from employees as a result of employee stock option exercises for the years ended December 31, 2006, 2005 and 2004 was \$376, NIL and \$331 thousands, respectively. In connection with these

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exercises, the tax benefits realized by the company for the years ended December 31, 2006, 2005 and 2004 were NIL, NIL and \$100 thousands respectively.

### 2. Stock options subject to performance conditions:

In May 2006, a total of 277,000 options were granted under May 2006 plans (see 1b ahead) to 11 executive officers, are subject to achievement of certain performance goals. The exercise price of the options is \$8.43, equal to the closing price of the ordinary shares of the Company on the Tel Aviv Stock Exchange on May 11, 2006 converted to US dollars based on the exchange rate of the US dollar on that date. The vesting of 141,000 and 136,000 options is subject to the Company's pre-tax net income, excluding one-time capital gains, in 2007, and 2008, respectively.

The options vest over a period of two years subject to achievement of certain performance goals and service conditions. One half of the options, which are vested in 2008, will be exercisable for a period of three years commencing two years from the date of grant. The second half of the options, which are vested in 2008, will be exercisable for a period of three years commencing three years from the date of grant. One half of the options, which are vested in 2009, will be exercisable for a period of three years commencing three years from the date of grant. The second half of the options, which are vested in 2009, will be exercisable for a period of four years commencing four years from the date of grant.

As of December 31, 2006, 71,000 options granted to certain employees who left the Company, were forfeited.

The fair value of option granted during 2006, based on the Black & Scholes option pricing model was \$518 thousands and will be recorded in the financial statement over the vesting period, subject to occurrence of the performance conditions.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 9 - SHAREHOLDERS' EQUITY (continued):

The fair value of each option granted is estimated on the date of grant using the Black & Scholes option-pricing model, with the following weighted average assumptions:

2006  
-----  
WEIGHTED  
AVERAGE  
-----

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|                          |        |
|--------------------------|--------|
| Dividend yield           | 4.0%   |
|                          | =====  |
| Expected volatility      | 31.00% |
|                          | =====  |
| Risk-free interest rate  | 5%     |
|                          | =====  |
| Expected life - in years | 4.38   |
|                          | =====  |

The expenses relating to the options which are subject to achievement of certain performance goals were not recorded in the financial statements in 2006 due to the fact that the probability of meeting those goals was improbable.

The total unrecognized compensation cost before tax on employee stock options at December 31, 2006 is \$518 thousands.

3. The grant of options until 2004 to Israeli employees under the Company's plans is subject to the terms stipulated by Section 102 and 102A of the Israeli Income Tax Ordinance. Inter-alia, that Section provides that the Company will be allowed to claim as an expense for tax purposes the amounts credited to the employees as a benefit, when the related tax is payable by the employee. The grant of options in 2006 is subject to the track chosen by the company and pursuant to the terms thereof, the company is not allowed to claim, as an expense for tax purposes, the amounts credited to employees as a benefit, including amounts recorded as salary benefits in the company's accounts, in respect of options granted to employees under the plan - with the exception of the work-income benefit component, if any, determined on the grant date. Treatment of the options granted under the plan for U.S. employees as incentive stock options, which have certain tax benefits for those receiving the options.
4. The rights pertaining to the ordinary shares issued upon exercise of the options will be identical to those of the other ordinary shares of the Company.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9 - SHAREHOLDERS' EQUITY (continued):

5. Following is a summary of the status of the Company's stock option plans:
  - a. Options subject to service conditions:

YEAR ENDED DECEMBER 31

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|  | 2006        |                                 | 2005        |                                 | NUMBER |
|--|-------------|---------------------------------|-------------|---------------------------------|--------|
|  | NUMBER (**) | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER (**) | WEIGHTED AVERAGE EXERCISE PRICE |        |
| Options outstanding at beginning of year | 1,562,005   | \$13.21                         | 1,832,071   | \$13.84                         | 1,830, |
| Changes during the year:                 |             |                                 |             |                                 |        |
| Granted - at market price                | 1,068,018   | \$ 7.98                         |             |                                 | 110,   |
| Exercised(*)                             | (45,713)    | \$ 8.31                         |             |                                 | (41,   |
| Forfeited                                | (88,536)    | \$ 8.86                         | (23,000)    | \$ 9.00                         | (66,   |
| Expired                                  | (208,167)   | \$19.14                         | (247,066)   | \$18.30                         |        |
| Options outstanding at end of year       | 2,287,607   | \$10.50                         | 1,562,005   | \$13.21                         | 1,832, |
| Options exercisable at end of year       | 1,235,875   | \$12.39                         | 1,238,005   | \$13.79                         | 1,106, |

(\*) The total intrinsic value of options exercised during the years ended December 31, 2006, 2005, and 2004, was \$0.2 \$NIL, and \$0.1 millions, respectively.

(\*\*) Represents the number of shares arising upon exercise of options, based on the conversion rat.

b. Options subject to performance conditions:

|  | 2006     |                                 |
|--|----------|---------------------------------|
|  | NUMBER*  | WEIGHTED AVERAGE EXERCISE PRICE |
| Options outstanding at beginning of year | -,-      |                                 |
| Options outstanding at beginning of year | -,-      |                                 |
| Changes during the year:                 |          |                                 |
| Granted - at market price                | 277,000  | \$8.43                          |
| Forfeited                                | (71,000) | \$8.43                          |
| Options outstanding at end of year       | 206,000  | \$8.43                          |
| Options exercisable at end of year       | -,-      |                                 |

(\*) The weighted-average grant-date fair value of options granted during the years 2006, 2005, and 2004 was \$0.5 millions, \$NIL, and \$NIL, respectively.

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NOTE 9 - SHAREHOLDERS' EQUITY (continued):

6. The following table summarizes information regarding options outstanding at December 31, 2006:

| NUMBER OF SHARES ISSUABLE UPON EXERCISE OF OPTIONS |                 |                              |   |                              |
|--|-----------------|------------------------------|---|------------------------------|
| OUTSTANDING  |                 |                              |   | VESTED AND EXERCISABLE       |
| DATE OF PLAN                                       | EXERCISE PRICES | BALANCE AT DECEMBER 31, 2006 | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS) | BALANCE AT DECEMBER 31, 2006 |
| June 2000  | \$21.07         | 318,125                      | 1.1   | 318,125                      |
| October 2002                                       | \$ 9.00         | 840,250                      | 1.6   | 840,250                      |
| October 2002                                       | \$10.76         | 30,000                       | 2.1   | 22,500                       |
| October 2002                                       | \$15.35         | 80,000                       | 3.1   | 40,000                       |
| October 2002                                       | \$12.74         | 22,500                       | 3.3   | 15,000                       |
| May 2006   | \$ 8.43         | 496,730                      | 5.2   |                              |
| May 2006 -<br>Performance<br>conditioned           | \$ 8.43         | 206,000                      | 6   |                              |
| May 2006   | \$ 7.26         | 425,000                      | 5.5   |                              |
| May 2006   | \$ 7.59         | 25,002                       | 5.5   |                              |
| May 2006   | \$ 9.20         | 50,000                       | 5.5   |                              |
|  |                 | 2,493,607                    |   | 1,235,875                    |

Weighted average of exercise prices of the total outstanding and of total vested and exercisable options is \$10.33 and \$12.39 respectively.

Weighted average of remaining contractual life of the total outstanding and the total vested and exercisable options is 3.5 years 1.55 years respectively.

Weighted average of intrinsic value of the total outstanding and of total vested and exercisable options is \$1.31 and \$3.42 respectively.

C. RETAINED EARNINGS

In determining the amount of retained earnings available for distribution as a dividend, the Companies Law stipulates

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that the cost of the Company's shares acquired by the Company (that are presented as a separate item in the statement of changes in shareholders' equity) has to be deducted from the amount of retained earnings.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued):

A. THE COMPANY AND CERTAIN ISRAELI SUBSIDIARIES (HEREAFTER - THE COMPANIES):

- 1) Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 ("the law")

The Company and certain Israeli subsidiary have received investment grants from the State of Israel. The entitlement to the above benefits is conditional upon the companies fulfilling the conditions stipulated by the law, regulation published thereunder and the instruments of approval for the specific investments in approved enterprises. In the event of failure to comply with the terms attached to the receipt of those grants, the companies may be required to refund the amount of the grants, in whole or in part, with linkage differences to the Israeli CPI and interest from the date of receipt, see note 4.

The abovementioned companies have registered floating charges on all their assets in favor of the State of Israel as security for compliance with the terms relating to the grants.

- 2) Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (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. Under income tax regulations, the Company and certain subsidiaries are entitled to adjust their results for tax purposes on the basis of the changes in the exchange rate of the dollar, instead of the changes in the Israeli CPI. The Company and one of its subsidiaries chose to do so.

As explained in note 1a(4), the financial statements were measured in dollars. Paragraph 9(f) of FAS 109 creates an exception which prohibits the recognition of deferred tax liabilities or assets that arise from differences between the financial reporting and tax bases of assets and liabilities that are remeasured from the local currency into dollars using historical exchange rates, and that result from (i) changes in exchange rates, or (ii) indexing for tax purposes.

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### 3) Tax rates

The income of the Company and its Israeli subsidiaries is taxed at the statutory rate. In July 2004, Amendment No. 140 to the Income Tax Ordinance was enacted. In August 2005, a further amendment (No. 147) 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 corporate tax rates for 2006 and thereafter are as follows: 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and for 2010 and thereafter - 25%.

As a result of the 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 when the deferred tax asset or liability is expected to be settled or realized. The effect of the change has been carried to income on a current basis.

Capital gains are taxed at a reduced rate of 25% on the capital gains derived after January 1, 2003, and at the regular corporate tax rate on the gains derived through the aforementioned date.

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DELTA GALIL INDUSTRIES LTD..  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 10 - TAXES ON INCOME (continued):

#### 4) Tax benefits under the Law for the Encouragement of Industry (Taxation), 1969

The Company and certain Israeli subsidiary are "industrial companies" as defined by this law. As such, these companies are entitled to certain tax benefits, consisting mainly of accelerated depreciation, as stipulated by regulations published under the inflationary adjustments law, and the right to claim public issuance expenses as a deduction for tax purposes.

Pursuant to this law, the Company files consolidated tax returns with the said subsidiary.

#### B. NON-ISRAELI SUBSIDIARIES

Subsidiaries that are incorporated outside of Israel, except which incorporated in the free zone, are assessed for tax under the tax laws in their countries of residence. The principal tax rates applicable to main subsidiaries outside Israel are as follows:

Company incorporated in the USA - tax rate of 38%-40%  
Company incorporated in U.K. - tax rate of 30%

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C. CARRYFORWARD TAX LOSSES

Carryforward tax losses mainly derived from the Israeli companies as of December 31, 2006 and 2005, aggregate to \$75 million and \$59 million, respectively.

Carryforward tax losses in Israel may be utilized indefinitely.

D. DEFERRED INCOME TAXES:

- 1) The deferred income taxes are composed as follows:  
DECEMBER 31

|   | 2006         | 2005       |
|---|--------------|------------|
|   | -----        | -----      |
|   | IN THOUSANDS |            |
|   | -----        | -----      |
| Property, plant and equipment                           | \$ 7,442     | \$ 8,198   |
| Inventories   | (1,906)      | (1,824)    |
| Provisions for employee related obligations             | (1,113)      | (1,377)    |
| Intangible assets                                       | 862          | 255        |
| Other   | (907)        | (371)      |
| In respect of carry forward tax losses<br>(see c above) | (19,572)     | (17,539)   |
| Valuation Allowance                                     | 12,254       | 8,932      |
|   | -----        | -----      |
|   | \$ (2,940)   | \$ (3,726) |
|   | =====        | =====      |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued):

- 2) Deferred income taxes are presented in the balance sheets as follows:

|                             | DECEMBER 31 |            |
|-----------------------------|-------------|------------|
|                             | -----       | -----      |
|                             | 2006        | 2005       |
|                             | -----       | -----      |
| Among current assets        | \$ (4,779)  | \$ (4,726) |
| Among non-current assets    | (320)       | (267)      |
| Among long term liabilities | 2,159       | 1,267      |
|                             | -----       | -----      |
|                             | \$ (2,940)  | \$ (3,726) |
|                             | =====       | =====      |

E. INCOME (LOSS) BEFORE TAXES ON INCOME IS COMPOSED AS FOLLOWS:

| YEAR ENDED DECEMBER 31 |       |       |
|------------------------|-------|-------|
| -----                  | ----- | ----- |
| 2006                   | 2005  | 2004  |
| -----                  | ----- | ----- |
| IN THOUSANDS           |       |       |
| -----                  |       |       |



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|  |            |             |           |
|--|------------|-------------|-----------|
| The Company and its Israeli subsidiaries | \$ (1,674) | \$ (26,757) | \$ 3,190  |
| Non-Israeli subsidiaries                 | 11,101     | (11,365)    | 13,946    |
|  | -----      | -----       | -----     |
|  | \$ 9,427   | \$ (38,122) | \$ 17,136 |
|  | =====      | =====       | =====     |

F. INCOME TAX EXPENSE (BENEFIT) INCLUDED IN THE STATEMENTS OF OPERATIONS:

|                     | YEAR ENDED DECEMBER 31 |            |          |
|---------------------|------------------------|------------|----------|
|                     | 2006                   | 2005       | 2004     |
|                     | -----                  |            |          |
|                     | IN THOUSANDS           |            |          |
|                     | -----                  |            |          |
| Current:            |                        |            |          |
| Israeli             | \$1,954                | \$ 1,422   | \$1,636  |
| Non-Israeli         | 3,498                  | 2,911      | 1,941    |
|                     | -----                  | -----      | -----    |
|                     | 5,452                  | 4,333      | 3,577    |
|                     | -----                  | -----      | -----    |
| Deferred:           |                        |            |          |
| Israeli             | \$ 53                  | \$ (2,970) | \$ (498) |
| Non-Israeli         | 786                    | (1,902)    | 219      |
|                     | -----                  | -----      | -----    |
|                     | 839                    | (4,872)    | (279)    |
|                     | -----                  | -----      | -----    |
| For previous years: |                        |            |          |
| Israeli             | \$ (80)                | \$ (173)   | \$ (516) |
| Non-Israeli         | (427)                  | (1,590)    | 64       |
|                     | -----                  | -----      | -----    |
|                     | (507)                  | (1,763)    | (452)    |
|                     | -----                  | -----      | -----    |
|                     | \$5,784                | \$ (2,302) | \$2,846  |
|                     | =====                  | =====      | =====    |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 - TAXES ON INCOME (continued):

- G. Following is a reconciliation of the theoretical tax expense (benefit), assuming all income is taxed at the regular tax rates applicable to income of companies in Israel (35% in 2004, 34% in 2005 and 31% in 2006) and the actual tax expense (benefit):

|  | YEAR ENDED DECEMBER 31 |       |
|--|------------------------|-------|
|  | 2006                   | 2005  |
|  | -----                  | ----- |
|  | IN THOUSANDS           |       |
|  | -----                  |       |

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|  |         |            |
|--|---------|------------|
| Income (loss) before taxes on income, as reported<br>in the consolidated statements of operations  | \$9,427 | \$(38,122) |
|  | =====   | =====      |
| Theoretical tax expense (benefit)  | \$2,922 | \$(12,961) |
| Additional tax expenses arising from reduced tax<br>rate on losses from an approved enterprise   |         |            |
| Increase (decrease) in tax arising from different tax<br>rate applicable to non-Israeli subsidiaries   | 129     | 1,926      |
|  | -----   | -----      |
|  | 3,051   | (11,035)   |
| Increase (decrease) in taxes resulting from<br>permanent differences:  |         |            |
| Disallowable deductions  | 380     | 2,455      |
| Adjustments from previous years  | (507)   | (1,763)    |
| Difference between the basis of measurement<br>of income reported for tax purposes and<br>the basis of measurement of income for<br>financial reporting purposes - net | (636)   | 453        |
| Valuation allowance  | 3,322   | 8,932      |
| Change in the tax rates on which tax expense was computed  |         | 1,154      |
| Other - net  | 174     | (2,498)    |
|  | -----   | -----      |
| Taxes on income - in the consolidated statements<br>of operations  | \$5,784 | \$(2,302)  |
|  | =====   | =====      |

H. TAX ASSESSMENTS

Tax assessments for the Company and most of its Israeli subsidiaries are considered final through the tax year 2001.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:

BALANCE SHEETS:

|  | DECEMBER 31  |           |
|--|--------------|-----------|
|  | 2006         | 2005      |
|  | -----        | -----     |
|  | IN THOUSANDS |           |
|  | -----        | -----     |
| A. ACCOUNTS RECEIVABLE:                    |              |           |
| 1) Trade:                                  |              |           |
| Outside Israel                             | \$ 94,850    | \$ 91,126 |
| In Israel                                  | 14,860       | 13,298    |
|  | -----        | -----     |
|  | \$109,710    | \$104,424 |
|  | =====        | =====     |
| Principal customers (see note 1n and 14d): |              |           |
| Customer 1                                 | \$ 12,681    | \$ 8,556  |
|  | =====        | =====     |
| Customer 2                                 | \$ 27,910    | \$ 21,361 |

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|                                 |           |           |
|---------------------------------|-----------|-----------|
|                                 | =====     | =====     |
| Customer 3                      | \$ 10,923 | \$ 11,153 |
|                                 | =====     | =====     |
| 2) Other:                       |           |           |
| Government departments          | \$ 1,651  | \$ 2,935  |
| Prepaid expenses                | 2,601     | 2,365     |
| Deposits                        | 164       | 1,009     |
| Income receivable               | 78        | 103       |
| Employees                       | 384       | 311       |
| Receivables from subcontractors | 1,253     | 4,159     |
| Sundry                          | 1,442     | 2,362     |
|                                 | -----     | -----     |
|                                 | \$ 7,573  | \$ 13,244 |
|                                 | =====     | =====     |

|                                     |              |           |
|-------------------------------------|--------------|-----------|
|                                     | DECEMBER 31  |           |
|                                     | -----        | -----     |
|                                     | 2006         | 2005      |
|                                     | -----        | -----     |
|                                     | IN THOUSANDS |           |
|                                     | -----        | -----     |
| B. INVENTORIES:                     |              |           |
| Finished products                   | \$ 99,154    | \$108,984 |
| Products in process                 | 12,451       | 16,247    |
| Raw materials and supplies          | 14,612       | 15,914    |
| Packaging and maintenance materials | 5,339        | 5,997     |
|                                     | -----        | -----     |
|                                     | \$131,556    | \$147,142 |
|                                     | =====        | =====     |

C. SHORT-TERM BANK CREDIT

The weighted average interest rate of short-term bank credit as of December 31, 2006 and 2005 is 6.3% and 5.1%, respectively. A subsidiary is a party to a credit agreement, which was amended, as of December 9 2004, 2006 and during 2007, with Bank Leumi U.S.A and Bank Hapoalim B.M. Borrowings under the credit agreement are secured by substantially all of the assets of the subsidiary. The credit agreement provides for up to \$90 million in short term credit (see note 7e).

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DELTA GALIL INDUSTRIES LTD.  
 (An Israeli corporation)  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

Unutilized short-term credit lines of the Group (under the USA credit agreement and other credit agreements) as of December 31, 2006 and 2005 aggregated to \$90 million and \$109 million, respectively.

|  |             |       |
|--|-------------|-------|
|  | DECEMBER 31 |       |
|  | -----       | ----- |
|  | 2006        | 2005  |
|  | -----       | ----- |

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|  | IN THOUSANDS |          |
|--|--------------|----------|
|  | -----        |          |
| D. ACCOUNTS PAYABLE AND ACCRUALS - OTHER:  |              |          |
| Employees and employee institutions  | \$10,163     | \$ 8,532 |
| Provision for vacation and recreation pay  | 3,594        | 3,179    |
| Government department  | 4,294        | 6,571    |
| Accrued expenses   | 13,481       | 17,008   |
| Accrued expenses - restructuring expenses  | 136          | 3,250    |
| Provision for additional payment to Burlen's<br>previous shareholders, see note 2a | 2,400        |          |
| Other  | 436          | 624      |
|  | -----        | -----    |
|  | \$34,504     | \$39,164 |
|  | =====        | =====    |

STATEMENTS OF OPERATIONS:

E. RESTRUCTURING EXPENSES:

- 1) Consolidated statements of operations for the year ended December 31, 2006 include restructuring expenses in China totaling \$1.7 million. Consolidated statements of operations for the year ended December 31, 2005 include restructuring expenses in Delta USA, US Upper market, Europe and Socks segments totaling approximately \$9.1 million. During the year ended December 31, 2004 the Company implemented restructuring plan in the European segment totaling approximately \$1.1 million.
- 2) The primary components of the restructuring expenses are:

|                                       | YEAR ENDED DECEMBER 31 |         |         |
|---------------------------------------|------------------------|---------|---------|
|                                       | -----                  |         |         |
|                                       | 2006                   | 2005    | 2004    |
|                                       | -----                  |         |         |
|                                       | IN THOUSANDS           |         |         |
|                                       | -----                  |         |         |
| Costs relating to workforce reduction | \$ 507                 | \$5,894 | \$ 190  |
| Write-off of fixed assets             | 1,156                  | 2,370   | 50      |
| Receivables write-off                 |                        | 180     | 860     |
| Costs relating to other expenses      |                        | 658     |         |
|                                       | -----                  | -----   | -----   |
|                                       | \$1,663                | \$9,102 | \$1,100 |
|                                       | =====                  | =====   | =====   |

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

THE 2006 PROGRAM

During 2006 the Company decided to restructure operations in the Far East and closed its sewing plant in China (the "2006 program"), due to a decision to focus the Chinese operations on procurement of finished goods, raw materials and product development, and also due to re-imposed quotas productions in China starting 2006. Restructuring

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expenses included \$1.2 million for impairment of leasehold improvements and \$0.5 million provision for severance payments related to employee dismissal.

The implementation of the 2006 program in China, resulted in the dismissal of approximately 700 employees.

The restructuring program was completed by the end of 2006.

### THE 2005 PROGRAM

During 2005 the Company initiated a restructuring program designated to reduce its cost structure and increase efficiency (the "2005 program"). Restructuring expenses include the closure of a sewing plant in Carmiel, Israel in a total cost of \$0.4 million and a dismissal of approximately 200 employees and the following steps included in the restructuring program initiated in the third quarter of 2005 both designated to reduce its cost structure and increase efficiency:

- a. Closure of a sewing plant in Central America and moving the production to subcontractors in the Far East, and a distribution center in New Jersey, both served Delta Galil USA segments. The closure of this sewing plant resulted in total restructuring costs of \$1.1 million and resulted in the dismissal of approximately 1,400 employees.
- b. Closure of a socks manufacturing plant in Toronto, Canada and moving its production to subcontractors in Central America and the Far East. The closure of this plant, resulted in a total restructuring costs of \$2.4 million and resulted in the dismissal of approximately 100 employees.
- c. Reduction of manufacturing facilities in Israel and transfer the operations to lower labor cost countries. These actions resulted in a total restructuring costs of \$4.1 million and will result in the dismissal of approximately 585 employees.
- d. Consolidation of various departments into one building in Carmiel, Israel in order to reduce maintenance and other overhead costs. This action resulted in a total cost of \$1.1 million.
- e. The plan was completed in 2006.

### THE 2004 PROGRAM

During the fourth quarter of 2004 the Company initiated a restructuring program designed to reduce its cost structure (the "2004 Program"). The 2004 Program included the closure of a logistic center in Hungary and resulted in total restructuring costs of \$1.5 million, from which \$0.4 million included among cost of sales (related to inventory).

The implementation of the 2004 Program in Hungary, consisted of the dismissal of approximately 230 persons who had previously been employed by the Company's Hungary subsidiary. The 2004 Program was concluded in 2005.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

- 3) The following table summarizes changes to in the restructuring accrual and other recognized restructuring expenses for the 3 years ended December 31, 2006, in thousand:

|                     | YEAR ENDED DECEMBER 31, 2006                  |                          |            |            | ACCRUAL<br>BALANCE AT<br>DECEMBER 31,<br>2006 |
|---------------------|---|--------------------------|------------|------------|---|
|                     | ACCRUAL<br>BALANCE AT<br>DECEMBER 31,<br>2005 | RESTRUCTURING<br>EXPENSE | WRITE-OFF  | PAYMENT    |   |
| Cost relating to:   |   |                          |            |            |   |
| Workforce reduction | (*)\$3,408                                    | \$ 507                   |            | \$ (3,505) | (*) 410                                       |
| Asset write-off     |   | 1,156                    | (1,156)    |            |   |
| Other expenses      | 512   |                          |            | (512)      |   |
|                     | -----   | -----                    | -----      | -----      | -----   |
|                     | \$3,920                                       | \$1,663                  | \$ (1,156) | \$ (4,017) | 410   |
|                     | =====   | =====                    | =====      | =====      | =====   |

|                       | YEAR ENDED DECEMBER 31, 2005                  |                          |            |            | ACCRUAL<br>BALANCE AT<br>DECEMBER 31,<br>2005 |
|-----------------------|---|--------------------------|------------|------------|---|
|                       | ACCRUAL<br>BALANCE AT<br>DECEMBER 31,<br>2004 | RESTRUCTURING<br>EXPENSE | WRITE-OFF  | PAYMENT    |   |
| Cost relating to:     |   |                          |            |            |   |
| Workforce reduction   | --  | (*)\$5,894               |            | \$ (2,486) | (*)\$3,408                                    |
| Fixed asset write-off |   | 2,370                    | (2,370)    |            |   |
| Other expenses        |   | 658                      |            | (146)      | 512   |
| Receivable write-off  |   | 180                      | (180)      |            |   |
|                       | ---   | -----                    | -----      | -----      | -----   |
|                       | --  | \$9,102                  | \$ (2,550) | \$ (2,632) | \$3,920                                       |
|                       | ===   | =====                    | =====      | =====      | =====   |

|                     | YEAR ENDED DECEMBER 31, 2004                  |                          |          |           | PAYMENT  |
|---------------------|---|--------------------------|----------|-----------|----------|
|                     | ACCRUAL<br>BALANCE AT<br>DECEMBER 31,<br>2003 | RESTRUCTURING<br>EXPENSE | REVERSAL | WRITE-OFF |          |
| Cost relating to:   |   |                          |          |           |          |
| Workforce reduction |   |                          | \$ 190   |           | \$ (190) |

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|  |         |              |            |          |            |
|--|---------|--------------|------------|----------|------------|
| Workforce reduction -relating to acquisition of subsidiary | 2,063   |              |            |          | (2,063)    |
| Fixed asset write-off                                      |         | 50           |            | (50)     |            |
| Other accruals related to acquisition of subsidiary        | 4,100   | (**) 500     | (1,863)    |          | (2,737)    |
| Receivable write-off                                       |         | 860          |            | (860)    |            |
|  | -----   | -----        | -----      | -----    | -----      |
|  | \$6,163 | (**) \$1,600 | \$ (1,863) | \$ (910) | \$ (4,990) |
|  | =====   | =====        | =====      | =====    | =====      |

(\*) As of December 31, 2006 and 2005, Including \$410 and \$670 thousand, respectively for long term workforce reduction accruals. The Company will pay this accrual in 14 equal quarterly installments.

(\*\*) The amount of \$500 thousands was charged to other comprehensive loss related to differences from translations of foreign currency financial statements.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 - SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

F. FINANCIAL EXPENSES - NET:

|                                      | YEARS ENDED DECEMBER 31 |          |         |
|--------------------------------------|-------------------------|----------|---------|
|                                      | 2006                    | 2005     | 2004    |
|                                      | -----                   | -----    | -----   |
|                                      | IN THOUSANDS            |          |         |
|                                      | -----                   | -----    | -----   |
| Interest expenses                    | \$11,907                | \$9,891  | \$4,923 |
| Interest income                      | (520)                   | (245)    | (42)    |
| Exchange differences and other - net | 2,010                   | 572      | 763     |
| Losses from derivatives instruments  | 161                     |          | 587     |
|                                      | -----                   | -----    | -----   |
|                                      | \$13,558                | \$10,218 | \$6,231 |
|                                      | =====                   | =====    | =====   |

G. EARNINGS (LOSS) PER SHARE

Following is data relating to the weighted average number of shares used in the computation of diluted earnings (loss) per share:

|  | 2006         | 2005  | 2004  |
|--|--------------|-------|-------|
|  | -----        | ----- | ----- |
|  | IN THOUSANDS |       |       |
|  | -----        | ----- | ----- |

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|   |        |        |        |
|---|--------|--------|--------|
| Weighted average number of shares used in the computation of basic earnings (loss) per share                        | 18,700 | 18,695 | 18,478 |
| Add:  |        |        |        |
| Net additional shares from the anticipated exercise of stock options  | 42     |        | 356    |
|   | -----  | -----  | -----  |
| Weighted average number of shares used in the computation of diluted earnings per share                             | 18,742 | 18,695 | 18,834 |
|   | =====  | =====  | =====  |
| Options which were not included in the computation of diluted earnings (loss) per share due to anti dilutive effect | 2,452  | 1,560  | 798    |
|   | =====  | =====  | =====  |

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DELTA GALIL INDUSTRIES LTD.  
 (An Israeli corporation)  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:

A. GENERAL

The Group operates internationally, which gives rise to exposure to market risks mainly from changes in exchange rates of foreign currencies in relation to the US dollar. The group utilize derivative financial instruments ("derivatives") to reduce these risks, as explained in this note. As the counter parties to these derivatives are Israeli banks, the Company considered the inherent credit risks remote. The Company did not hold or issue derivative financial instruments for trading purposes.

B. FOREIGN EXCHANGE RISK MANAGEMENT

The Company usually enters into foreign currency derivatives - forward exchange contracts - in order to protect itself from the risk that the eventual non-dollar net cash flows resulting from sales of products would be affected by changes in exchange rates. The term of these contracts is less than one year.

These transactions were mainly for the exchange of pounds sterling and Euro into US dollars.

For forward exchange contracts designated as cash flow hedges, gains and losses were recorded in other comprehensive income (loss) until the foreign currency denominated sales, were recognized in earnings.

The following table summarizes changes in other comprehensive income (loss) related to derivatives that were classified as cash flow hedges held by the Company during the reported years:



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|   | 2006            | 2005  | 2004      |
|---|-----------------|-------|-----------|
|   | -----           | ----- | -----     |
|   | \$ IN THOUSANDS |       |           |
|   | -----           | ----- | -----     |
| Balance at beginning of year  |                 | -, -  | \$(1,715) |
| Changes in effective portion of derivatives<br>designated as cash flow hedges | \$(275)         |       | 691       |
| Reclassification into earnings from other<br>comprehensive income             |                 |       | 1,822     |
| Tax effect  |                 |       | (798)     |
|   | -----           | ---   | -----     |
| Balance at end of year  | \$(275)         | -;-   | -;-       |
|   | =====           | ===   | =====     |

Loss related to the portion of cash flow hedging instruments excluded from assessment of hedge effectiveness had impact on earnings for 2006, 2005 and 2004 of NIL, NIL and \$0.6 million loss respectively, classified in financial expenses.

The fair value of the hedge instrument as of December 31, 2006 and 2005 are \$272 thousand and NIL.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

C. FAIR VALUE OF FINANCIAL INSTRUMENTS

The financial instruments of the Group consist mainly of non-derivative assets and liabilities in insignificant amounts (items included in working capital, long-term receivables and long-term liabilities); the Group also has derivatives financial instruments.

In view of their nature, the fair value of the financial instruments included in working capital of the Group is usually identical or close to their carrying value. The fair value of long-term receivables and long-term loans also approximates their carrying value, since they bear interest at rates close to the prevailing market rates.

NOTE 13 - RELATED PARTIES - TRANSACTIONS AND BALANCES:

A. TRANSACTIONS WITH RELATED PARTIES:

| YEAR ENDED DECEMBER 31 |       |       |
|------------------------|-------|-------|
| 2006                   | 2005  | 2004  |
| -----                  | ----- | ----- |
| IN THOUSANDS           |       |       |
| -----                  |       |       |

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|                              |       |       |         |
|------------------------------|-------|-------|---------|
| Net revenues                 | \$540 | \$409 | \$1,303 |
|                              | ===== | ===== | =====   |
| Purchases and other expenses | -,-   | \$ 7  | \$ 21   |
|                              | ===== | ===== | =====   |

The above transactions were made with a company which is held by one of the main Company's shareholders in the ordinary course of business, at prices agreed upon in negotiations between the parties, taking into account the volume of orders, at customary supplier credit terms.

As to options granted to the Company's former CEO, see note 9b.

B. RELATED PARTIES BALANCES:

|   |              |       |
|---|--------------|-------|
|   | DECEMBER 31  |       |
|   | -----        |       |
|   | 2006         | 2005  |
|   | -----        | ----- |
|   | IN THOUSANDS |       |
|   | -----        |       |
| Current receivables - presented in the balance sheets among "accounts receivable - trade" | \$128        | -,-   |
|   | =====        | ===== |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION :

A. INFORMATION ON OPERATING SEGMENTS:

OPERATING SEGMENTS:

1) General:

The Company conducts its worldwide operations in seven operating segments as follows:

- (i) Delta USA (Mass market); (ii) U.S upper market and (iii) Europe - these segments are engaged in manufacturing and marketing of intimate apparel to various customers in the U.S and European markets; (iv) Socks- the segment is engaged in manufacturing and marketing of socks to various customers in the U.S and European markets; (v) Delta marketing Israel - this segment is engaged in marketing of intimate apparel, mainly under the Delta Brand name, to various customers in Israel through retail and wholesale operations; (vi) Seam-less operation and (vii) China.

The Company's reportable segments are based on the 7 divisions internally reported and regularly reviewed by the Company's CEO. The Company's CEO is the Company's chief operating decision maker (CODM), for the purpose of making decisions about resources to be allocated to the segment and for assessing its performance. These 7 operating segments do not qualify for aggregation for segment reporting purposes.

Commencing early 2006, the Company made certain changes to the structure of its internal organization in a manner that caused the composition of its reportable segments to change. As a result, the Company has restated the corresponding items of segment information for the prior periods presented in a manner consistent with segment presentation for 2006.

Changes to our reportable segments are as follows:

1. The Elastic Tape facility, which was previously managed within the US Upper Market segment, is no longer being managed within this segment, therefore it is has been reclassified within "others" segment.
2. The Seam less operations, which were previously managed and reported as part of the US Upper Market segment are now separately managed and evaluated by the CODM. Therefore, operations have been reclassified as a separate reportable segment, entitled, "Seam-less".

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

- 2) Information on revenues, profit (losses) and assets of the reportable operating segments:
  - a) Measurement of revenues, profit (losses) and assets of the operating segments:

The measurement of revenues, profit (losses) and assets of the reportable operating segments is based on the same accounting principles applied in these financial statements, except for:

- 1) The effect of hedging transactions that were excluded from segment data.
- 2) The Company fully consolidates the operating results of certain subsidiary in its consolidated financial statements, while for operating segment data the Company includes only its share (approximately 50.1%) in the operating profits of this subsidiary as part of the US Upper market segment.

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Segment profits (losses) reflect the income (loss) from operations of the segment and do not include financial expenses, other income, income tax expenses, share in losses of associated company and minority interest, since those items are not allocated to the segments.

Selling prices of intersegment revenues are based on negotiation between the segments and when applicable upon market price.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

b) Financial data relating to reportable operating segments:

|                               | DELTA<br>USA           | US<br>UPPER<br>MARKET | EUROPE    | SOCKS     | DELTA<br>MARKETING<br>ISRAEL | SEAM-LESS | CHINA      |
|-------------------------------|------------------------|-----------------------|-----------|-----------|------------------------------|-----------|------------|
|                               | (U.S. \$ IN THOUSANDS) |                       |           |           |                              |           |            |
| Year ended December 31, 2006: |                        |                       |           |           |                              |           |            |
| Net revenues:                 |                        |                       |           |           |                              |           |            |
| To unaffiliated customers     | \$269,722              | \$94,543              | \$158,646 | \$121,980 | \$54,209                     | \$ 3,015  | \$ 8       |
| Intersegment                  |                        | \$ 754                | \$ 8,630  | \$ 504    | \$ 99                        | \$14,956  | \$ 1,0     |
| Total net revenues            | \$269,722              | \$95,297              | \$167,276 | \$122,484 | \$54,308                     | \$17,971  | \$ 1,8     |
| Operating income (loss)       | \$ 13,254              | \$ 692                | \$ 7,693  | \$ 1,374  | \$ 6,777                     | \$(2,452) | (3) \$(4,1 |
| Assets (at end of year)       | \$195,101              | \$46,695              | \$ 80,811 | \$ 49,402 | \$24,955                     | \$18,002  | \$ 2,5     |
| Assets held for sale          | \$ 191                 |                       | \$ 3,517  |           |                              |           |            |
| Depreciation and amortization | \$ 2,639               | \$ 2,760              | \$ 5,130  | \$ 1,900  | \$ 790                       | \$ 1,100  | \$ 6       |

(1) Includes general corporate expenses not assignable to segments.

(2) Includes general corporate assets not assignable to segments.

(3) Includes restructuring expenses in the amount of \$1.7 million with respect of the closing of the sewing activity.

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DELTA GALIL INDUSTRIES LTD.

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(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

b) Financial data relating to reportable operating segments:

|                               | DELTA USA              | US UPPER<br>MARKET (*) | EUROPE         | SOCKS          | DELTA<br>MARKETING<br>ISRAEL |
|-------------------------------|------------------------|------------------------|----------------|----------------|------------------------------|
|                               | (U.S. \$ IN THOUSANDS) |                        |                |                |                              |
| Year ended December 31, 2005: |                        |                        |                |                |                              |
| Net revenues:                 |                        |                        |                |                |                              |
| To unaffiliated customers     | \$267,887              | \$ 75,306              | \$163,245      | \$126,760      | \$49,038                     |
| Intersegment                  |                        | \$ 384                 | \$ 214         | \$ 4,126       |                              |
|                               | -----                  | -----                  | -----          | -----          | -----                        |
| Total net revenues            | \$267,887              | \$ 75,690              | \$163,459      | \$130,886      | \$49,038                     |
|                               | =====                  | =====                  | =====          | =====          | =====                        |
| Operating income (loss)       | (1) \$ 5,625           | (2) \$ (12,623)        | (3) \$ (8,827) | (4) \$ (4,990) | \$ 5,010                     |
|                               | =====                  | =====                  | =====          | =====          | =====                        |
| Assets (at end of year)       | \$194,515              | \$ 45,456              | \$101,789      | \$ 50,085      | \$24,847                     |
|                               | =====                  | =====                  | =====          | =====          | =====                        |
| Assets held for sale          | \$ 990                 |                        | \$ 4,723       | \$ 941         |                              |
|                               | =====                  | =====                  | =====          | =====          | =====                        |
| Depreciation and amortization | \$ 3,168               | \$ 3,026               | \$ 4,416       | \$ 2,220       | \$ 442                       |
|                               | =====                  | =====                  | =====          | =====          | =====                        |

|                               | SEAM-<br>LESS (*)      | CHINA      | OTHER (*) | ADJUSTMENTS (*) | TOTAL       |
|-------------------------------|------------------------|------------|-----------|-----------------|-------------|
|                               | (U.S. \$ IN THOUSANDS) |            |           |                 |             |
| Year ended December 31, 2005: |                        |            |           |                 |             |
| Net revenues:                 |                        |            |           |                 |             |
| To unaffiliated customers     | \$ 140                 |            | \$2,105   |                 | \$684,481   |
| Intersegment                  | \$19,413               | \$ 718     | \$3,898   | \$ (28,753)     |             |
|                               | -----                  | -----      | -----     | -----           | -----       |
| Total net revenues            | \$19,553               | \$ 718     | \$6,003   | \$ (28,753)     | \$684,481   |
|                               | =====                  | =====      | =====     | =====           | =====       |
| Operating income (loss)       | (5) \$ (9,126)         | \$ (2,313) | \$ 168    | (6) \$ (1,128)  | \$ (28,204) |
|                               | =====                  | =====      | =====     | =====           | =====       |
| Assets (at end of year)       | \$21,533               | \$ 4,760   | \$4,008   | (7) \$ 22,160   | \$469,153   |
|                               | =====                  | =====      | =====     | =====           | =====       |
| Assets held for sale          |                        |            |           | (7) \$ 766      | \$ 7,420    |
|                               | =====                  | =====      | =====     | =====           | =====       |
| Depreciation and amortization | \$ 1,671               | \$ 72      | \$ 262    | \$ 534          | \$ 15,811   |
|                               | =====                  | =====      | =====     | =====           | =====       |

(1) Includes restructuring expenses in the amount of \$1.1 million and impairment of fixed assets in the amount of \$1.5 million.

(2) Includes restructuring expenses in the amount of \$1.6 million, impairment of goodwill in the amount of \$2.1 million and impairment of fixed assets in

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the amount of \$3.5 million.

- (3) Includes restructuring expenses in the amount of \$2.1 million.
- (4) Includes restructuring expenses in the amount of \$4.1 million and impairment of goodwill in the amount of \$3.4 million.
- (5) Includes impairment of fixed assets in the amount of \$2.4 million.
- (6) Includes general corporate expenses not assignable to segments.
- (7) Includes general corporate assets not assignable to segments.
- (\*) See a1.

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

- b) Financial data relating to reportable operating segments (continued):

|                               | DELTA<br>USA           | US UPPER<br>MARKET (*) | EUROPE      | SOCKS     | DELTA<br>MARKETING<br>ISRAEL | SEAM-<br>LESS (*) | OT |
|-------------------------------|------------------------|------------------------|-------------|-----------|------------------------------|-------------------|----|
|                               | (U.S. \$ IN THOUSANDS) |                        |             |           |                              |                   |    |
| Year ended December 31, 2004: |                        |                        |             |           |                              |                   |    |
| Net revenues:                 |                        |                        |             |           |                              |                   |    |
| To unaffiliated customers     | \$186,280              | \$88,564               | \$193,638   | \$138,749 | \$46,460                     | \$ 558            |    |
| Intersegment                  |                        | \$ 1,781               | \$ 165      | \$ 5,435  |                              | \$19,413          |    |
| Total net revenues            | \$186,280              | \$90,345               | \$193,803   | \$144,184 | \$46,460                     | \$19,971          |    |
| Operating income (loss)       | \$ 5,911               | \$ 604                 | (4)\$ 4,906 | \$ 9,137  | \$ 4,753                     | \$(1,361)         |    |
| Assets (at end of year)       | \$225,744              | \$64,949               | \$100,264   | \$ 56,271 | \$23,866                     | \$29,227          |    |
| Depreciation and amortization | \$ 1,438               | \$ 3,964               | \$ 4,326    | \$ 2,463  | \$ 450                       | \$ 1,876          |    |

- (1) Includes results of hedge transactions.
- (2) Includes mainly the effect of hedge transactions in an amount of \$1.7 million.
- (3) Includes general corporate assets not assignable to segments.
- (4) Includes restructuring expenses in the amount of \$1.5 million relating to the closure of a logistic center in Hungary.

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(\*) See a1.

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DELTA GALIL INDUSTRIES LTD.  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

B. GEOGRAPHICAL INFORMATION:

|                               | YEAR ENDED DECEMBER 31 |           |           |
|-------------------------------|------------------------|-----------|-----------|
|                               | 2006                   | 2005      | 2004      |
|                               | -----                  |           |           |
|                               |                        |           |           |
|                               | -----                  |           |           |
|                               | IN THOUSANDS           |           |           |
|                               | -----                  |           |           |
| 1) Net revenues               |                        |           |           |
| attributed to geographic area |                        |           |           |
| (based on the location of the |                        |           |           |
| customers):                   |                        |           |           |
| North America                 | \$417,985              | \$401,050 | \$334,833 |
| United Kingdom                | 171,879                | 177,950   | 202,831   |
| Europe (other than U.K.)      | 53,896                 | 52,360    | 64,605    |
| Israel                        | 60,132                 | 53,121    | 52,000    |
| Other                         | 2,807                  |           |           |
|                               | -----                  | -----     | -----     |
|                               | \$706,699              | \$684,481 | \$654,269 |
|                               | =====                  | =====     | =====     |

2) The net balance of the Company's long-lived assets, by geographic location, are as follows:

|                | DECEMBER 31  |           |           |
|----------------|--------------|-----------|-----------|
|                | 2006         | 2005      | 2004      |
|                | -----        |           |           |
|                |              |           |           |
|                | -----        |           |           |
|                | IN THOUSANDS |           |           |
|                | -----        |           |           |
| Israel         | \$42,015     | \$ 45,508 | \$ 57,685 |
| Egypt          | 24,616       | 26,270    | 24,464    |
| United States  | 12,061       | 13,582    | 15,637    |
| Jordan         | 7,066        | 8,212     | 9,470     |
| Eastern Europe | 4,470        | 5,243     | 11,370    |
| China          | 2,387        | 4,761     |           |
| Thailand       | 3,452        | 2,923     | 2,108     |
| United Kingdom | 1,683        | 2,076     | 3,831     |
| India          | 1,131        |           |           |
| Ireland        |              | 129       | 1,184     |
| Other          | 382          | 427       | 2,592     |
|                | -----        | -----     | -----     |
|                | \$99,263     | \$109,131 | \$128,341 |
|                | =====        | =====     | =====     |

C. SALES BY PRODUCT CATEGORY INFORMATION:

YEAR ENDED DECEMBER 31

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|                         | 2006      | 2005      | 2004      |
|-------------------------|-----------|-----------|-----------|
| IN THOUSANDS            |           |           |           |
| 1) Net revenues         |           |           |           |
| Ladies intimate apparel | \$408,807 | \$417,942 | \$350,688 |
| Socks                   | 136,134   | 138,499   | 150,482   |
| Men's underwear         | 104,256   | 75,722    | 84,400    |
| Leisurewear             | 25,267    | 20,899    | 24,207    |
| Babywear                | 23,367    | 17,193    | 28,788    |
| Fabrics and Other       | 8,868     | 14,226    | 15,704    |
|                         | \$706,699 | \$684,481 | \$654,269 |

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DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 - SEGMENT INFORMATION (continued):

D. REVENUES FROM PRINCIPAL CUSTOMERS:

|   | YEAR ENDED DECEMBER 31 |           |           |
|---|------------------------|-----------|-----------|
|   | 2006                   | 2005      | 2004      |
| IN THOUSANDS                              |                        |           |           |
| Customer 1 (Europe and Socks segments)    | \$155,827              | \$161,348 | \$188,947 |
| Customer 2 (Delta USA and Socks segments) | \$151,474              | \$150,556 | \$ 86,177 |
| Customer 3 (Delta USA segment)            | \$ 57,977              | \$ 67,064 | \$ 70,157 |

NOTE 15 - SUBSEQUENT EVENTS:

Options

- a. On March 2007 the Company granted 122,000 options to 8 employees at an exercise price of \$6.95.

Of the total options granted, 120,000 are vest and exercisable as follows: First third vest on the second anniversary of the date of grant and are exercisable for three years thereafter, second third vest on the third anniversary of the date of grant and are exercisable for three years thereafter and the final third vest on the fourth anniversary of the date of grant and are exercisable for three years thereafter.

The remaining 2,000 options are vest and exercisable as follows: First



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quarter vest on the first anniversary of the date of grant and are exercisable for three years from the second anniversary of the date of grant, second quarter vest on the second anniversary of the date of grant and are exercisable for three years thereafter, third quarter vest on the third anniversary of the date of grant and are exercisable for three years thereafter and the final third vest on the fourth anniversary of the date of grant and are exercisable for three years thereafter.

The fair value of the options granted, based on the Black-Scholes Option-Pricing Model, is approximately \$0.2 million and will be included in the financial statement over the vesting period.

### b. Restructuring Plan For 2007

On March 28, 2007, the Company approved a restructuring plan, which includes the planned closure of certain manufacturing facilities in Israel, and the downsizing of operations that may involve certain changes to the Company's operational structure, development and design functions, and marketing, sales and finance operations. The Company estimates the costs associated with this restructuring plan to range between \$10 million to \$12 million. The implementation of the restructuring plan is expected to take place commencing in the second quarter of 2007.

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENT SCHEDULE

To the shareholders of

DELTA GALIL INDUSTRIES LTD.

Our audits of the consolidated financial statements, referred to in our report dated March 30, 2007 appearing in the 2006 Annual Report on form 20-F of Delta Galil Industries Ltd. also included an audit of Financial Statement Schedule II-Valuation and Qualifying Accounts - included as an exhibit in Item 19 of this Form 20-F. In our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements

Tel-Aviv, Israel  
March 30, 2007

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

DELTA GALIL INDUSTRIES LTD.  
(An Israeli corporation)

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS  
THREE YEARS ENDED DECEMBER 31, 2006  
(U.S. \$ IN THOUSAND)

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|   | BALANCE AT<br>BEGINNING<br>OF YEAR | ADDITION -<br>CHARGED TO<br>COSTS AND<br>EXPENSES | DEDUCTION-<br>CHARGED TO<br>ACCOUNTS<br>RECEIVABLE | DEDUCTION-<br>CHARGED TO<br>COST &<br>EXPENSES | BALANCE A<br>END OF<br>YEAR |
|---|------------------------------------|---|--|--|-----------------------------|
| ALLOWANCE FOR DOUBTFUL ACCOUNTS:                            |                                    |   |  |  |                             |
| Year ended December 31, 2006                                | \$ 453                             | \$ 211  |  | \$ (112)                                       | \$ 552                      |
| Year ended December 31, 2005                                | \$ 127                             | \$ 340  |  | \$ (14)  | \$ 453                      |
| Year ended December 31, 2004                                | \$ 1,038                           | \$ 26   | \$ (827)   | \$ (110)                                       | \$ 127                      |
| ALLOWANCE FOR SALES RETURN:                                 |                                    |   |  |  |                             |
| Year ended December 31, 2006                                | \$ 174                             | \$ 572  |  | \$ (174)                                       | \$ 572                      |
| Year ended December 31, 2005                                | \$ 81                              | \$ 174  |  | \$ (81)  | \$ 174                      |
| Year ended December 31, 2004                                | \$ 80                              | \$ 81   |  | \$ (80)  | \$ 81                       |
| ALLOWANCE FOR OBSOLETE AND SLOW<br>MOVING INVENTORY:        |                                    |   |  |  |                             |
| Year ended December 31, 2006                                | \$27,879                           | \$26,732  |  | \$ (27,879)                                    | \$26,732                    |
| Year ended December 31, 2005                                | \$26,292                           | \$27,879  |  | \$ (26,292)                                    | \$27,879                    |
| Year ended December 31, 2004                                | \$25,926                           | \$26,292  |  | \$ (25,926)                                    | \$26,292                    |
| VALUATION ALLOWANCE IN RESPECT OF<br>DEFERRED INCOME TAXES: |                                    |   |  |  |                             |
| Year ended December 31, 2006                                | \$ 8,932                           | \$ 3,322  |  |  | \$12,254                    |
| Year ended December 31, 2005                                | -,-                                | \$ 8,932  |  |  | \$ 8,932                    |
| Year ended December 31, 2004                                | -,-                                |   |  |  | -,-                         |

SIGNATURE

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

DELTA GALIL INDUSTRIES LTD.

By: /s/ Yossi Hajaj

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Name: Yossi Hajaj  
Title: Chief Financial Officer

Date: March 30, 2007

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- 1.1 Memorandum of Association, as amended\*\*
- 1.2 Articles of Association\*\*
- 2.1 Form of Deposit Agreement and ADR\*
- 4.1 Stock Purchase Agreement dated as of December 8, 2004 by and among Steven Klein, Kristina Nettesheim, and Gary Beggs, as selling shareholders and Delta Galil Industries Ltd. and Delta Galil USA Inc. as Purchaser relating to the acquisition of Burlen Corp ^\*\*\*\*\*
- 4.2 Second Amended and Restated Credit and Security Agreement dated as of December 9, 2004 by and among Delta Galil USA Inc., as Borrower; Bank Leumi USA and Bank Hapoalim B.M., as Lenders and Bank Leumi USA, as Agent\*\*\*\*
- 4.3 Amendment No.1 to Burlen Stock Purchase Agreement ^\*\*\*\*\*
- 4.4 Amendment No.1, dated January 12, 2006, and Amendment No. 2, dated May 9, 2006, to the Second Amended and Restated Credit and Security Agreement \*\*\*\*\*
- 4.5 Amendment No. 3, dated July 31, 2006, to the Second Amended and Restated Credit and Security Agreement.
- 4.6 Amendment No. 4, dated January 26, 2007, to the Second Amended and Restated Credit and Security Agreement.
- 4.7 Option Plan to 13 employees of Delta Galil and/or its subsidiaries\*
- 4.8 Option Plan to Arnon Tiberg\* (Delta's Former CEO)
- 4.9 Option Plan to 70 employees of Delta Galil and/or its subsidiaries\*\*\*
- 4.10 Delta Galil Industries Ltd. 2002 Share Option Plan\*\*\*\*\*
- 4.11 Form of Indemnification Undertaking\*\*\*\*\*
- 4.12 2006 Incentive Plan\*\*\*\*\*
- 4.13 Delta Galil Industries Ltd. 2006 Option Plan \*\*\*\*\*
- 8.1 List of significant subsidiaries \*\*\*\*\*
- 12.1 Section 302 Certification of Aviram Lahav.
- 12.2 Section 302 Certification of Yossi Hajaj.
- 13.1 Section 906 Certification of Aviram Lahav.
- 13.2 Section 906 Certification of Yossi Hajaj.
- 14.1 Consent of Resselman & Kesselman, a member of PricewaterhouseCoopers, International Limited

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\* Previously filed as an exhibit to Delta Galil's Registration Statement on Form F-1 (Registration No. 333-10062) filed with the Securities and Exchange Commission on February 26, 1999 and incorporated herein by reference.

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- \*\* Previously filed as an exhibit to Delta Galil's Annual Report on Form 20-F (File No .0-30020) filed with the Securities and Exchange Commission on June 8, 2001 and incorporated herein by reference.
- \*\*\* Previously filed as an exhibit to Delta Galil's Registration Statement on Form S-8 (Registration No. 333-12608) filed with the Securities and Exchange Commission on September 26, 2000 and incorporated herein by reference.
- \*\*\*\* Previously filed as an exhibit to Delta Galil's Annual Report on Form 20-F (File No. 0-30020) filed

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with the Securities and Exchange Commission on June 27, 2005 and incorporated herein by reference.

- \*\*\*\*\* Previously filed as an exhibit to Delta Galil's Registration Statement on Form S-8 (Registration No. 353-102247) filed with the Securities and Exchange Commission on December 30, 2002 and incorporated herein by reference.
- \*\*\*\*\* Previously filed as an exhibit to Delta Galil's Annual Report on Form 20-F (File No. 0-30020) filed with the Securities and Exchange Commission on June 26, 2003 and incorporated herein by reference.
- \*\*\*\*\* Previously filled as an exhibit to Delta Galil's Annual Report on Form F-20 (file No. 0-50020) filed with the Securities and Exchange Commission on June 28, 2006 and incorporated herein by reference.
- ^ Portions of this exhibit have been omitted and filed separately with the secretary of the Securities and Exchange Commission pursuant to a confidential treatment request.

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