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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, 2004**

Commission file number **0-30020**

**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:

**None**

(Title of each class)

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

**Ordinary Shares (1)**

(Title of Class)

**American Depositary Shares (2)**

(Title of Class)

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

**None**

(Title of class)

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, 2004 the Registrant had 19,947,849 ordinary shares outstanding (including 1,206,802 ordinary shares owned by the Registrant and 45,882 ordinary shares held by a trustee in connection with the Registrant's stock option plans).**

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

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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 19,947,849 ordinary shares outstanding as of June 20, 2005. Percentages of outstanding shares used herein are based on 18,695,165 ordinary shares outstanding as of June 20, 2005, which excludes 1,206,802 ordinary shares held by Delta Galil, and 45,882 ordinary shares held by a trustee in connection with Delta Galil’s stock option plans.

## **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**

#### **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.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(\$ in thousands, except per share data)				
<b>Statement of Income Data:</b>					
Net revenues .....	\$434,404	\$558,763	\$567,298	\$580,130	\$654,269
Cost of revenues.....	338,498	453,036	454,238	463,863	533,036
Gross profit .....	95,906	105,727	113,060	116,267	121,233
Selling, marketing, general administrative expenses, goodwill amortization .....					
	60,631	82,067	84,135	82,089	98,646
Restructuring expenses .....	1,810	900	1,065	1,007	1,100
Gain (loss) on sale of assets and subsidiary shares .....	(117)	(553)	(92)	3,645	922
Operating income.....	33,348	22,207	27,768	36,816	22,409
Financial expenses – net .....	6,608	4,751	5,456	5,637	6,231
Other income - net .....	975	463	960	252	958
Income before taxes on income .....	27,715	17,919	23,272	31,431	17,136
Taxes on income .....	5,511	5,876	5,779	7,340	2,846
Income after taxes on income ...	22,204	12,043	17,493	24,091	14,290
Share in profits (losses) of associated companies – net .....	340	110	158	(300)	(237)
Minority interests – net .....	(563)	(729)	(1,025)	(439)	(1,368)
Net income.....	<u>\$21,981</u>	<u>\$11,424</u>	<u>\$16,626</u>	<u>\$23,352</u>	<u>\$12,685</u>
EPS					
Basic .....	<u>\$1.23</u>	<u>\$0.60</u>	<u>\$0.88</u>	<u>\$1.28</u>	<u>\$0.69</u>
Diluted .....	<u>\$1.22</u>	<u>\$0.60</u>	<u>\$0.88</u>	<u>\$1.24</u>	<u>\$0.67</u>
Weighted average number of shares used in computation(1).....					
Basic.....	17,771	19,175	18,914	18,313	18,478
Diluted.....	17,996	19,199	18,927	18,763	18,834
Cash dividend per ordinary shares (2).....	\$0.37	\$0.30	\$0.37	\$0.52	\$0.45

(1) See note 13g of the notes to Delta Galil's consolidated financial statements included in Item 18 of this annual report for a discussion of the shares used to compute net income per share for the years ended December 31, 2002, 2003 and 2004.

(2) Until 2001, dividends were declared and paid in NIS and such amounts have been translated into U.S. dollars here as a convenience. Beginning in 2002, dividends, if any, are declared and paid in dollars.

**Year ended December 31,**

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
	(\$ in thousands)				
<b>Balance Sheet Data:</b>					
Cash and cash equivalents .....	\$ 8,633	\$ 12,762	\$14,491	\$17,699	\$22,150
Working capital <sup>(1)</sup> .....	68,079	74,020	67,945	56,612	127,382
Total assets <sup>(1)</sup> .....	371,044	424,965	441,058	450,884	534,497
Shareholders' equity .....	185,447	198,189	197,829	212,334	221,081
Amount of Share Capital .....	21,679	21,792	21,792	21,830	21,840

<sup>(1)</sup> The increase in the working capital and in total assets as of December 31, 2004 versus previous years is attributed to the acquisition of Burlen in December 2004, and to Delta Galil's decision to increase its long-term loans and decrease short-term loans.

**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:

- our anticipated growth strategies;
- our intention to introduce new products;
- anticipated trends in our business;
- future expenditures for capital projects; and
- our ability to continue to control costs and maintain quality.

Forward-looking statements can be identified by the use of 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 all quotas on apparel and textiles. As a result, all textiles and textile apparel manufactured in a member nation will no longer be subject to quota restrictions. This will allow 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.

**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 2004, 28.9% of Delta Galil's revenues were from sales to Marks & Spencer, Delta Galil's largest customer. Sales to Wal-Mart reached 13.2% of revenues and sales to Target reached 10.7% of revenues. Delta Galil expects Wal-Mart to be its largest customer in 2005, as a result of the December 2004 acquisition of Burlen Corporation. Delta Galil's contracts with its customers, including Marks & Spencer and Wal-Mart, 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 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 2004, Delta Galil produced goods in Jordan, Egypt, Turkey, Honduras, Eastern Europe and the Far East that accounted for approximately 82% of Delta Galil's 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 account for 38% of our 2004 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 fluctuate due to seasonal purchasing by consumers. Revenues in the last two quarters of the year generally exceed 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 2004, Delta Galil derived 30% of its revenues from customers in pound sterling, 8% in NIS, and 9% in euros. More than 10% of Delta Galil's expenses were in NIS in 2004.

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, resulting in a negative effect on Delta Galil's profitability in those years.

In order to limit Delta Galil's exposure to fluctuations in the exchange rate between the 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 Disclosure – 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 working towards integration with Delta Galil of 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. Furthermore, the acquired companies are located in North America and Ireland, where we have limited operating experience. 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 a number of manufacturers of apparel, some of which have longer operating histories, are closer geographically to customers 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 Delta Galil's customers are unable to successfully compete in their markets, Delta Galil's sales 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.

**Dov Lautman and Sara Lee own almost 50% of Delta Galil's outstanding shares, and together can control Delta Galil's management.**

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. Sara Lee beneficially owns 4,256,537 ordinary shares, representing 22.8% of the ordinary shares outstanding. Mr. Lautman and the companies that he controls have a shareholders' agreement with Sara Lee that requires each party to vote the shares it beneficially owns to elect directors designated by Sara Lee 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 Sara Lee. Mr. Lautman and Sara Lee have also given one another the first opportunity to buy any shares the other party wishes to sell. Mr. Lautman and Sara Lee together have the power to elect all of the directors other than independent directors, appoint management and, in practice, approve actions requiring the approval of a majority of Delta Galil's shareholders.



**Sara Lee could use its ownership position to influence Delta Galil's operations to benefit Sara Lee.**

Approximately 0.2% of Delta Galil's 2004 revenues were derived from sales to affiliates of Sara Lee. Delta Galil is under no obligation to sell any products to Sara Lee. However, Sara Lee may attempt to use its ownership position to influence Delta Galil's operations. Israeli law requires special approvals for extraordinary transactions with a controlling shareholder, such as Sara Lee, and for transactions in which a director is deemed to have a personal interest. In the event that a director of Delta Galil also serves as the chief executive or as a director of an affiliate of Sara Lee, that Delta Galil director would be deemed to have a personal interest in transactions between that Sara Lee affiliate and Delta Galil, and such transactions would be subject, under Israeli law, to special approvals. However, if no Delta Galil director is a director or chief executive of the other party, transactions, other than extraordinary transactions, between Delta Galil and Sara Lee or its affiliates would not require special approvals.

**Dov Lautman, Delta Galil's Chairman, founder and principal shareholder, 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 principal shareholder 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. 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<sup>®</sup> 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 fluctuates 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:

- adverse changes in foreign regulations, export restrictions, tariffs, trade barriers and tax rules;
- difficulty in staffing and managing international operations;
- longer payment cycles and difficulties in collecting accounts receivable; and
- changes in social, political and economic conditions.

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 are entitled to Israeli government grants and tax benefits. Delta Galil received grants totaling \$1.6 million in 2002, \$1.1 million in 2003 and \$1.1 million in 2004 under these programs. 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 1998 and thereafter. This lower grant rate applies to any applications for grants made in 1998 or thereafter. There can be no assurance that the Israeli government 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."

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 those free trade advantages would eliminate an important competitive advantage.**

Delta Galil benefits from Israel's status as the only country in the world enjoying free trade agreements with the United States, Canada, the European Union and the European Free Trade Association. The agreements permit Delta Galil to sell its Israeli manufactured products to these trade partners free of customs duties and import quotas. Similar benefits are available to Delta Galil's products manufactured in Egypt, since Egypt has a free trade agreement with the European Union and with the United States. The benefits of the Israel-United States Free Trade Area Agreement also apply to goods processed in an area of Jordan in which Delta Galil produces

**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**

### **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, 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:

- Marks & Spencer (U.K.)
- Victoria's Secret (U.S.)
- Kmart (U.S.)
- Wal-Mart (U.S.)
- Hema (Holland)
- Mervyn's (U.S.)
- Target (U.S.)
- JC Penney (U.S.)

and to marketers of leading brand names, including:

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

Delta Galil also sells its products in Israel under the Delta brand name.

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:

- product line planning and design;
- manufacture of high quality knitted apparel using automated manufacturing processes; and
- 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 and Turkey as well as countries in the Far East and in Central America.

### **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:

- *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.
- *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.

- *Effective management of manufacturing and logistics.* Delta Galil maintains an advanced infrastructure of computerized acquisition, production, inventory control, dispatching, shipping and billing functions. These systems have enabled Delta Galil to effectively manage its geographically dispersed operations. As a result, Delta Galil is able to shift labor-intensive production functions to lower labor cost countries while maintaining the high levels of quality and timely delivery standards that its customers require.
- *Unique free trade status.* Israel is currently the only country in the world that 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:

- *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.
- *Develop relationships with selected new customers.* Delta Galil is 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 Puma, Polo, and Levi's (Europe), Ann Taylor and Nicole Miller (North America), Carrefour and Metro.
- *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.
- *Pursue strategic acquisitions.* In 2000 Delta Galil completed the acquisitions of Dominion Hosiery Mills and Wundies Industries, in 2001 of Inner Secrets. In 2003, Delta Galil acquired Auburn Hosiery Mills and in 2004 Delta acquired Burlen Corporation, as more fully described below. Delta Galil may pursue additional strategic acquisitions of businesses that would complement its product lines and customer relationships.
- *Branding.* The market positioning of brands is becoming more and more prominent. Behind each such brand there is a message, which brings the consumer, above all, the emotional attachment and the experience of buying. As part of this strengthening trend, Delta, strategically is going in this direction, by licensing leading brands in the market. The latest are Levi's Signature, for socks, men's and ladies underwear for the European market, and Nicole Miller worldwide. Both completely handled by Delta from the initial processes to finished products and inventory management. Delta Galil is looking for additional license agreements.

## **Recent Acquisitions**

### *Acquisition of Burlen*

In December 2004, Delta Galil acquired Burlen Corp., a leading private label manufacturer of ladies intimate apparel with sales of \$113 million in 2004. 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 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 will be paid in 2005. Delta is also obligated to pay the selling shareholders additional amounts if Burlen meets specified sales and profitability targets for 2005, 2006, and 2007.

The Burlen acquisition is a positive step in Delta's strategy to increase its intimate apparel category of the mass market. We believe that there are opportunities for synergies between Burlen's operations and Delta's existing activities, which we expect to strengthen Delta's position in the mass market.

#### *Acquisition of Auburn*

In November 2003, Delta Galil acquired, the socks business of Kellwood Company. Operating under the name Auburn Hosiery Mills, the business includes operations in both the United States and Europe.

Auburn manufactures, markets and sells branded sport socks under exclusive licenses to brand names of Wilson® and Converse® in the United States and Europe and Coca-Cola® in Europe. Auburn sources in the United States, Mexico and Ireland and sells in North America and Europe. Wal-Mart is Auburn's main customer in the United States.

This acquisition is a favorable addition to Delta's socks business by adding well-known brand names to the existing lines, penetrating into the US mass market in the socks category and increasing Delta's marketing capabilities in the United States and Europe.

In 2003, Delta paid \$10.8 million in cash to Kellwood and recorded liabilities in respect of restructuring costs in the amount of \$6.2 million. During 2004 Delta Galil finalized the restructuring plan and actual liabilities in respect of restructuring costs were \$1.9 million less than originally anticipated. As a result, goodwill, which was originally estimated at \$1.4 million, was reduced to zero, and the value of the property, plant and equipment was reduced by \$0.5 million.

#### *Acquisition of Inner Secrets*

In 2001, Delta Galil, through its subsidiary, Wundies Industries Inc., completed the acquisition of Inner Secrets Inc., a New Jersey corporation, and its subsidiaries. Inner Secrets manufactured and marketed private label brassieres and other ladies' intimate apparel.

At the time of the acquisition, Inner Secrets manufactured its products in its factory in the Dominican Republic (which was closed in the first quarter of 2002) and outsourced to sub-contractors in the Far East, including Hong Kong, China, Indonesia and Bangladesh, as well as other countries including Guyana, Mexico, Haiti, and Columbia. Inner Secrets had a distribution center in Harrison, New Jersey.

Inner Secrets had many quality customers, catering mainly to the mass market, including Target, Wal-Mart and Kmart.

As of December 31, 2001 Wundies Industries, which Delta Galil acquired in 2000, and Inner Secrets were merged into a new company, Delta Galil USA Inc.

As consideration for all of the share capital of Inner Secrets, Delta Galil paid \$48.7 million in cash, of which \$14.4 million was for retirement of bank and other debt, and \$5.9 million in ordinary shares, comprised of 454,020 ordinary shares valued at \$13.05 per ordinary share. The goodwill attributed to the purchase of Inner Secrets amounted to approximately \$24.3 million. In April 2003 and 2004, Delta Galil USA paid \$2.0 million and \$6.7 million respectively in accordance with the acquisition agreement, as additional performance payments. These payments were allocated as part of the 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. Delta Galil's products 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 2002, 2003 and 2004.

<u>Product Category</u>	<u>Key Products</u>	<u>Key Customers/Brands</u>	<u>% of Revenues</u>			
			<u>2002</u>	<u>2003</u>	<u>2004</u>	
Ladies' Intimate Apparel	Fashion and basic panties and bras Women's nightwear Girl's nightwear	Marks & Spencer Wal-Mart Target JC Penney Victoria's Secret	Calvin Klein Hema Kmart	59%	61%	54%
Socks	Men's, women's and children's leisure, dress and sport socks	Marks & Spencer Nike Wal-Mart Hema Tchibo	Dim JC Penney Matalan Sears	15%	16%	23%
Men's Underwear	Briefs Boxer shorts Mini-briefs Undershirts Men's nightwear	Calvin Klein Gap Hema Hugo Boss Marks & Spencer	Schiesser Target J. Crew Polo Ralph Lauren	11%	10%	13%
Babywear	Fashion and classic items, focusing on newborns	Marks & Spencer		7%	7%	4%
Leisurewear	T-shirts Polo shirts Sweatshirts Leisure clothes	Marks & Spencer		4%	3%	4%
Others	Fabrics, elastic tapes and other operations			4%	3%	2%

- Ladies' Intimate Apparel:* Delta Galil's intimate apparel items include both fashion and basic underwear, as well as bras. Delta Galil has introduced machinery to produce seam-free panties, tops and control underwear. Delta Galil has been shifting its product mix to increase its focus on these products. The decrease in this category in 2004 is mainly due to a decrease in sales to US mass-market customers. Sales to this category in 2005 are expected to increase due to the acquisition of Burlen.
- 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 increase in this category in 2004 is mainly due to the consolidation of Auburn.
- 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.
- Babywear:* Babywear includes fashion and classic daywear and sleepsuits in a wide variety of styles and fabrics, with a focus on newborns. Delta Galil products in this category are sold at medium to high retail prices. In the first quarter of 2005 the sales of this category continue to decrease and reached 2% of total sales.
- 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 that are sold at medium to high retail prices.
- Others:* This category includes sales of production overruns of fabrics and elastic tapes.



## **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.

### *The North American Market*

Recognizing the North American market's size and diversification, Delta Galil has 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 \$334.8 million (which represented 51% of sales) in 2004. Our five largest customers in North America, Wal-Mart, Target, Victoria's Secret, JC Penney and Calvin Klein, represented approximately 79% of our 2004 sales in North America. We are expecting an increase in sales to this market in 2005 mainly due to the acquisition of Burlen.

### *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 sells, on an average basis, approximately, 7.0 million units to the Marks & Spencer distribution center per month. Delta Galil is a diversified supplier to Marks & Spencer, selling to over 15 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 \$189 million in 2004, representing 29% of Delta Galil's revenues in 2004. In 2004 sales were positively affected by the strengthening of the pound sterling versus the US dollar, which led to an increase of 6% in dollar terms, while in pound sterling sales decreased by 4%, mainly due to a decrease in the children category.

### *Israeli Market*

Delta Galil believes that it is among the market leaders in Israel for men's underwear, ladies' intimate apparel and socks, with \$46.5 million of sales in 2004. 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, 43% were made through retail department stores and supermarkets, and 57% were made through Delta Galil's Delta Plus factory outlets. As of December 31, 2004 Delta Plus had 81 stores, of which we owned 48 directly and 33 were franchises.

## **Seasonality**

Delta Galil's revenues fluctuate due to seasonal purchasing by consumers. Revenues in the last two quarters of the year generally exceed 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 the following steps:

- *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<sup>®</sup> 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.
- *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 150 automatic knitting machines, with a total production capacity of approximately 550-570 tons of fabric per month depending on the type of fabric produced. During 2004, Delta Galil produced approximately 450 tons of fabric per month, approximately 96% of which Delta Galil used and the remainder of which 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.

- *Dyeing and Finishing:* Delta Galil has its own dyeing plants in Israel and North America for dyeing yarns, fabrics and products. The dyeing plants are 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.
- *Cutting:* Delta Galil uses computerized, automatic cutting equipment, which minimizes fabric waste.
- *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 12 million units per month (depending on the type of product). Delta Galil operates 9 sewing plants, three in Jordan, four in Egypt, one in Honduras and one in Thailand. Delta Galil also subcontracts sewing functions, primarily to contractors in Israel, Egypt, Eastern Europe, the Far East and Central America.
- *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 assurance procedures meet the very strict quality control standards of its customers.

### *Seam-Free Manufacturing*

Applying technology utilized in the manufacture of hosiery, Delta Galil produces one-piece seam-free panties and bras. Seam-free 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.

The seam-free 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-free 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 and new technology. Delta Galil continuously engages in research and development to create additional products that use the seam-free technology. Nevertheless, sales of seam-free products decreased from \$40.2 million in 2000 to \$17.4 million in 2003. In 2004 sales increased by 29% compared to 2003 and amounted to \$22.5 million. The growth in Delta Galil sales is due to major improvement made in design and development of new products and increase in demand for seamless garments primarily in the US mass market. As of December 31, 2004, Delta Galil owned 275 seam-free knitting machines.

### *Outsourcing of Products*

Subcontractors manufactured goods in Egypt (babywear and underwear), Turkey (socks), Romania (bras and underwear), Bulgaria (socks) and Thailand, Hong Kong, Vietnam, Dominican Republic and China (all ladies intimate apparel), which in 2004 accounted for approximately 53% of Delta Galil's revenues. Delta Galil personnel closely supervise the production by subcontractors in these countries.

### *Jordanian Joint Venture*

In 1995, Delta Galil entered into 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.

### **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 increased to approximately \$25 million in 2004, as compared to \$23 million in 2003 and \$21 million in 2002.

### **Delta Galil's Manufacturing Facilities**

Delta Galil has manufacturing facilities in Israel, Jordan, Egypt, North America, Honduras, and Thailand. Delta Galil has also sub-contracts to manufacturers in Egypt, Turkey, Romania, 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 and East Europe. As a result all manufacturing plants in Scotland were closed by 2003 and the last sewing plant in Israel was closed on the first quarter of 2005. In 2004, 82% of Delta Galil's revenues were generated from the sale of products produced in low labor cost

countries, up from 49% in 2000. In 2004, goods produced in Israel represented 12% 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:

<u>Country</u>	<u>Activity</u>	<u>Products</u>	<u>% of Revenues year ended December 31</u>		
			<u>2002</u>	<u>2003</u>	<u>2004</u>
Far East	Purchase of finished products	Ladies intimate apparel	22%	30%	26%
	Sewing(1)				
	Cutting				
Egypt	Knitting(2)	Ladies' intimate apparel	19%	20%	18%
	Dyeing(1)	Men's underwear			
	Cutting	Babywear			
	Sewing(2)	Leisurewear			
	Purchase of finished products				
Israel	Design	Ladies' intimate apparel	14%	14%	12%
	Knitting(2)	Men's underwear			
	Dyeing	Socks			
	Cutting & sewing(2)	Knitted fabric			
	Production of fabrics & elastics	Elastic bands			
	Distribution center				
	Purchase of finished products				
Caribbean & Central America	Sewing(2)	Ladies' intimate apparel	15%	10%	10%
	Cutting	Socks			
	Knitting (1)				
	Purchase of finished products				
Jordan	Sewing(2)(3)(5)	Ladies' intimate apparel	13%	9%	13%
		Men's underwear			
Turkey	Purchase of finished products	Ladies intimate apparel, Socks	7%	7%	6%
Eastern Europe	Knitting(1)	Ladies' intimate apparel	5%	6%	9%
	Sewing(2)	Socks			
	Purchase of finished products				
North America	Design	Ladies' intimate apparel	4%	4%	6%
	Cutting	Socks			
	Dyeing				
	Knitting(2)				
	Distribution center				
Scotland	Design	Babywear	1%	0%	0%
	Cutting & sewing(4)	Leisurewear			
	Warehousing(4)				

(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) These activities were discontinued starting 2003.

(5) Fabric produced in Israel.

## **Management Information Systems**

Delta Galil has invested in information technology as a tool to reduce overall costs, 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 \$7 million in 2004 and intends to spend a similar amount in 2005 to enhance its system's capabilities in order to support the growing demand for Delta Galil's products.

## **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.

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. The unrest in and around the areas administrated by the Palestinian Authority 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 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 the United States, 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 status that currently has 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 EU, US and Egypt, Delta Galil's products manufactured in Egypt can enter the EU countries and into the US duty free as well. 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. The market has been characterized by strong pressure to lower prices. In addition, the State of Israel provides incentives that reduce the cost of equipment to Delta Galil and which may not be available in other countries.

## Delta Galil's Organizational Structure

Delta Galil is an Israeli corporation that commenced operations in 1975. It currently has 27 subsidiaries in which it holds at least a 50% interest. The main operations are included in the following companies:

<b>Company</b>	<b>Place of Incorporation</b>	<b>Ownership Interest</b>	<b>Function</b>
Delta Galil USA Inc.	Delaware, U.S.A.	100%	<ul style="list-style-type: none"> <li>Manufactures ladies and girls intimate apparel and owns Auburn Hosiery Mills and Burlen Corp.</li> </ul>
Auburn Hosiery Mills Inc.	Kentucky, USA	100%	<ul style="list-style-type: none"> <li>Manufacturing and marketing socks.</li> </ul>
Burlen Corp.	Georgia, USA	100%	<ul style="list-style-type: none"> <li>Manufacturing and marketing ladies intimate apparel.</li> </ul>
Delta Galil Europe Ltd.	U.K.	100%	<ul style="list-style-type: none"> <li>Distribution center and marketing services.</li> </ul>
Delta Galil Holland B.V.	Holland	100%	<ul style="list-style-type: none"> <li>Contract manufacture and owns Delta Galil's interest in Delta Textile Egypt-Free Zone S.A.E., Dominion Hosiery Inc., Century Wear Corporation (WLL), Delta Galil Hungary KFT, Delta Textile Bulgaria Ltd., Sport Socks and Thai Progress Garment Co. Ltd.</li> </ul>
Delta Textile Egypt - Free Zone S.A.E.	Egypt	100%	<ul style="list-style-type: none"> <li>Manufactures men's and women's underwear and leisurewear.</li> </ul>
Dominion Hosiery Inc.	Canada	100%	<ul style="list-style-type: none"> <li>Manufactures ladies' socks in Canada.</li> </ul>
Century Wear Corporation (WLL)	Jordan	50%*	<ul style="list-style-type: none"> <li>Joint venture in Jordan that performs sewing for the production of various products.</li> </ul>
Sport Socks Co Ltd.	Ireland	100%	<ul style="list-style-type: none"> <li>Manufacturing and marketing socks.</li> </ul>
Thai Progress Garment Co. Ltd	Thailand	100%	<ul style="list-style-type: none"> <li>Manufactures ladies intimate apparel.</li> </ul>
Delta Textile Marketing Ltd.	Israel	100%	<ul style="list-style-type: none"> <li>Factory outlets and wholesale.</li> </ul>
Delta Textile (New York) Ltd.	New York, U.S.A.	100%	<ul style="list-style-type: none"> <li>Marketing</li> </ul>
Delta Elastic Tapes Industries, Ltd.	Israel	90%	<ul style="list-style-type: none"> <li>Manufactures elastic tapes and other components used in underwear manufacture.</li> </ul>

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

## Property, Plant and Equipment

Delta Galil has manufacturing facilities in Israel, Jordan, Egypt, Turkey, Bulgaria, Canada, United States and Thailand. Delta Galil maintains its principal Israeli manufacturing, warehousing and administrative facilities in Carmiel, Daliat el-Carmel and Tel-Aviv. In Israel, Delta Galil owns six facilities, including its principal production facility in Carmiel, and leases nine facilities. The leases, including all extension options, for seven facilities expire on various dates between 2006 and 2013. The remaining lease expires in 2005, and Delta Galil is confident that it can renew that lease on terms no less favorable than the existing lease. Delta Galil also owns approximately 50 acres of undeveloped beachfront property surrounding its Nahariya facility. This property is zoned mainly for tourism or residential uses.

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 2019 and 2025. Delta Galil's joint venture in Jordan leases sewing and cutting facilities in Irbid, and in Amman.

Delta Galil leases manufacturing facilities in Canada, Honduras, and in Pennsylvania, as well as facilities in New Jersey and a facility in Hong Kong. These leases expire between 2005 and 2011. Delta Galil is confident that it can renew these leases on terms no less favorable than existing leases. Delta Galil also owns a facility in Rockingham, North Carolina, and other manufacturing facilities in Bulgaria, Kentucky USA and Ireland. 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.

The following table shows Delta Galil's main owned and leased properties and facilities as of June 20, 2005:

<u>Plant location</u>	<u>Square feet</u>	<u>Main function</u>
Carmiel, Israel	643,000	Textile manufacturing
Nahariya, Israel	257,000	Dyeing
Rosh Ha'ain, Israel	74,847	Offices and warehouse
Delta Plus retail chain, Israel	84,601	Retail
Yodfat, Israel	41,964	Warehouse
Daliat El Carmel, Israel	37,800	Elastic tape manufacturing
Tel Aviv, Israel	10,750	Main office
London, U.K.	25,000	Offices
Northampton, U.K.	125,000	Warehouse
Ireland	60,000	Offices
Jordan	272,000	Sewing and warehouse
Egypt	335,000	Knitting, cutting, sewing, warehouse and offices
New Jersey, U.S.	130,000	Warehouse and offices
New York, U.S.	5,000	Offices
Pennsylvania, U.S.	380,000	Warehouse, logistic center and offices
Kentucky, U.S.	250,000	Socks manufacturing, warehousing & offices
Tifton Georgia, U.S.	495,000	Logistic center, warehouse and offices
Honduras	108,000	Cutting, sewing and warehouse
Hong Kong	12,000	Offices and warehouse
Canada	92,000	Socks manufacturing
Hungary	129,000	Logistic center*
Bulgaria	95,000	Socks manufacturing
Thailand	18,000	Cutting and sewing
Guangzhou, China	300,500	Cutting and sewing**

\* Operation ceased during the first quarter of 2005.

\*\* Operation is scheduled to start in the third quarter of 2005.

### *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, and, in Israel, also by government grants.

	<b>Year Ended December 31</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Israel.....	\$5,892	\$5,909	\$6,602
Egypt.....	2,899	3,927	3,253
Eastern Europe.....	2,553	3,246	1,112
United Kingdom.....	408	754	314
North America.....	5,156	525	851
Jordan.....	703	396	914
Others.....	<u>117</u>	<u>168</u>	<u>438</u>
	<u>\$ 17,728</u>	<u>\$14,925</u>	<u>\$13,484</u>

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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 to better understand our results of operations discussed below:

#### Revenues

Delta Galil's revenues in 2004 increased by 13% and amounted to \$654.3 million compared to \$580.1 million in 2003.

The following table shows Delta Galil's revenues by geographical area, stated in million U.S. dollars and as a percentage of total revenues, for the years ended December 31, 2002, 2003 and 2004:

	Year ended December 31,					
	2002		2003		2004	
	\$	%	\$	%	\$	%
North America .....	303.1	53.4	300.7	51.8	334.8	51.2
United Kingdom .....	181.3	32.0	187.9	32.4	202.8	31.0
Europe (excluding U.K.) .....	44.4	7.8	48.7	8.4	64.7	9.9
Israel .....	<u>38.5</u>	<u>6.8</u>	<u>42.8</u>	<u>7.4</u>	<u>52.0</u>	<u>7.9</u>
Total .....	<u>567.3</u>	<u>100.0</u>	<u>580.1</u>	<u>100.0</u>	<u>654.3</u>	<u>100.0</u>

In 2004, sales to North America increased by 11.3% to \$334.8 million representing 51.2% of total sales. The increase in sales to North America is attributed mainly to the acquisitions of Auburn in 2003 and Burlen in 2004. Delta Galil's sales to its top customer, the U.K. chain Marks & Spencer, increased by 5.5% to \$189.0 million in 2004, compared to \$179.1 million in 2003. The increase in the sales to Marks & Spencer is attributed to the strengthening of the pound sterling versus the dollar. Delta Galil's sales to the European market increased by 32.8% to \$64.7 million in 2004 compared to \$48.7 million in 2003, mainly due to acquisition of Auburn in 2003 and the strengthening of the euro versus the dollar. Delta Galil's sales to the Israeli market increased by 21.5% to \$52.0 million in 2004 compared to \$42.8 million in 2003. The increase in sales to the Israeli market is attributed mainly to different mix of products and to the opening of new stores.

Effective January 1, 2005, the World Trade Organization's 148 member nations lifted all quotas on apparel and textiles. As a result, all textiles and textile apparel manufactured in a member nation will no longer be subject to quota restrictions. This will allow 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.

The following table shows Delta Galil's revenues by product categories, stated as a percentage of total revenues, for the years ended December 31, 2002, 2003, and 2004:

	<b>Year ended December 31</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Ladies' Intimate Apparel .....	59.2%	61.1%	53.6%
Socks .....	15.2	16.4	23.0
Men's Underwear.....	11.2	10.1	12.9
Babywear .....	7.2	6.8	4.4
Leisurewear .....	3.6	3.0	3.7
Fabrics and Others .....	3.6	2.6	2.4
Total.....	<u>100%</u>	<u>100%</u>	<u>100%</u>

The decrease in revenues in the Ladies Intimate Apparel in 2004 compared to 2003 is attributed to a decrease in sales to US mass-market customers. The increase in revenues in the Socks category in 2004 compared to 2003 is attributed to the acquisition of Auburn in the fourth quarter of 2003.

#### *Acquisition of Burlen*

In December 2004, Delta acquired Burlen Corp., a leading private label manufacturer of ladies intimate apparel.

As consideration for all of the share capital of Burlen Corp., 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 deal cost related to the transaction, which will be paid in 2005. Delta is also obligated to pay the selling shareholders additional amounts if Burlen meets specified sales and profitability targets in 2005, 2006, and 2007.

An intangible asset related to customer relations, which amounted to \$14.8 million will be amortized over a period of 20 years. The excess of cost of acquisition over the fair value of net assets on acquisition date - \$3.9 million - was allocated to goodwill and is included as part of Delta USA segment. Customer relations and goodwill are deductible for tax purposes.

#### *Acquisition of a manufacturing plant in Thailand*

In December 2004, Delta Galil acquired a manufacturing sewing and cutting facility in Thailand for a total consideration of \$2.4 million. Of this amount \$0.9 million was paid for the shares and \$0.8 million to pay off debt to the former shareholders. In addition, Delta assumed bank debt of \$0.7 million. Delta Galil accounted for this acquisition as an acquisition of a business. The excess of the cost of the acquisition over the fair value of the net assets on the acquisition date, which was approximately \$1.0 million, was allocated to goodwill and is included as part of Europe segment.

#### *Acquisition of Auburn Hosiery Mills*

On November 13, 2003 Delta Galil completed the acquisition of the outstanding shares of Auburn Hosiery Mills. Auburn manufactures, markets and sells branded sport socks under exclusive licenses to brand names both in the United States and Europe.

As consideration for all of the share capital of Auburn Hosiery, Delta Galil paid \$10.8 million to Kellwood and recorded liabilities in respect of restructuring costs in the amount of \$6.2 million. The total purchase price amounted to approximately \$17.0 million. During 2004, Delta Galil finalized the restructuring plan, and actual liabilities in respect of restructuring costs, were \$1.9 million less than originally anticipated which resulted in a decrease in the excess of cost of the acquisition over the fair value of the net assets on the acquisition date. The decrease was allocated \$1.4 million to the goodwill (which off set the entire goodwill initially recognized) and \$0.5 million to property, plant and equipment.

### *Logistic center in Hungary*

In November 2002, Delta Galil, through a wholly owned subsidiary, purchased the operations of Komar Textile Trading, a logistic center, which included real estate, movables and receivables from subcontractors in Hungary. The acquisition price was \$5.6 million, and the excess of the cost of the acquisition over the fair value of net assets amounted to \$0.8 million. During the fourth quarter of 2004, Delta Galil decided to close the logistic center, and accrued \$1.5 million for restructuring expenses. During the first half of 2005 the logistic center was closed.

### *Acquisition of Inner Secrets*

In 2001, Delta Galil, through its wholly owned subsidiary, Wundies Industries Inc., completed the acquisition of all of the outstanding shares of Inner Secrets Inc., a New Jersey corporation, and its subsidiaries. Inner Secrets manufactures and markets private label brassieres and other ladies' intimate apparel.

As consideration for all of the share capital of Inner Secrets, Delta Galil paid \$48.7 million in cash, of which \$14.4 million was for retirement of bank and other debt, and \$5.9 million in ordinary shares, comprised of 454,020 ordinary shares valued at \$13.05 per ordinary share. The goodwill attributed to the purchase of Inner Secrets amounted to approximately \$24.3 million.

In April 2003, Delta Galil USA paid \$2.0 million as an adjustment to the purchase price. A provision was made in 2002 for this payment, which was allocated as part of the goodwill.

In accordance with the acquisition agreement, and as a result of the performance of Delta Galil USA in 2003, Delta Galil paid the selling shareholders of Inner Secrets additional performance payment of \$6.7 million during April 2004. This payment was allocated as part of the goodwill.

### *Sale of Interests in Arad Towels and Standard Textile (Europe) Ltd.*

On December 31, 1998, Delta Galil sold its 40.7% interest in Arad Towels Ltd. to Standard Textile (Europe) Ltd. ("STE") for \$12.4 million in cash and a 15% interest in STE. The capital gain on this transaction totaled \$ 5.2 million, of which \$3.1 million was applied to income in 1998 and the balance of \$2.1 million was applied to income in 1999.

On August 6, 2000 Delta Galil entered into an agreement with S.T.I. Industries and Technologies Ltd., S.T.I.A. Holdings Ltd. and STE, for the sale of its 15% holdings in STE for \$9 million. The transaction is to be carried out in four installments, subject to adjustments as stipulated in the agreement. The first installment, 25% of the shares held by Delta Galil, was transferred to the buyers upon the signing of the agreement, for \$2.25 million. The second installment was transferred on January 15, 2002, for consideration of \$2.48 million, the third installment was transferred on January 15, 2003 for consideration of \$2.57 million and the fourth and final installment was transferred on January 15, 2004 for consideration of \$2.64 million. Delta Galil recognized a capital gain of \$0.9 million in 2003 and a capital gain of \$1.0 million in 2004 for this transaction.

### *Stock Repurchases*

In September 2001 Delta Galil's Board of Directors approved a plan for the repurchase of up to \$3 million of its ordinary shares within the following 12 months. By the end of 2002, Delta Galil completed the repurchase of 378,500 ordinary shares at an average price of \$7.9 per share.

In December 2002, Delta Galil successfully completed a self-tender offer in which it purchased 565,000 ordinary shares at a price per share of \$11.0, for aggregate consideration of \$6.2 million.

### *Employee stock option plan*

In October 2002, Delta Galil's Board of Directors approved an employee stock option plan for the grant, without consideration, of options exercisable to purchase 1,100,000 ordinary shares. The plan provides for forfeited options to return to the pool for future grants. In November 2002, the Company granted 1,004,500 options to 97 employees of the group (including 100,000 options granted to the CEO) at an exer-

cise price of \$9.0 per share. In May 2003 Delta Galil granted an aggregate of 30,000 options to three employees at an exercise price of \$10.76. In March 2004, Delta Galil granted 80,000 options to six employees at an exercise price of \$15.35 and in August 2004 Delta Galil granted an additional 30,000 options to one employee at an exercise price of \$12.74. The options granted in May 2003 and in 2004 are subject to the same terms and conditions as those granted in 2002.

The options are exercisable over a three-year period, following one year after the vesting date of the first batch and on the vesting date of the second, third and fourth batches. 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.

## 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:

	<b>Year ended December 31</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Revenues.....	100.0%	100.0%	100.0%
Cost of revenues .....	(80.1)	(80.0)	(81.5)
Gross profit.....	19.9	20.0	18.5
Selling, marketing, general and administrative .....	(14.8)	(14.1)	(15.1)
Restructuring expenses.....	(0.2)	(0.2)	(0.1)
Gain (loss) on sales of assets and subsidiary shares .....	*	0.6	0.1
Operating income .....	4.9	6.3	3.4
Financial expenses – net.....	(1.0)	(0.9)	(1.0)
Other income– net .....	0.2	*	0.2
Income before taxes on income .....	4.1	5.4	2.6
Taxes on income.....	(1.0)	(1.2)	(0.4)
Income after taxes on income .....	3.1	4.2	2.2
Share in profits (losses) of associated companies – net.....	*	(0.1)	(0.1)
Minority interests– net.....	(0.2)	(0.1)	(0.2)
Net income.....	<u>2.9%</u>	<u>4.0%</u>	<u>1.9%</u>

\* Less than 0.1%.

### *Segment Results*

We have five principal segments: Delta USA, U.S. Upper Market, Europe, Socks and Delta Marketing Israel. Delta USA, U.S. Upper Market and Europe segments are engaged in manufacturing and marketing of 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.

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

	<b>Sales by segment</b>		
	(\$ million)		
	<u>2002</u>	<u>2003</u>	<u>2004</u>
Delta USA <sup>(1)</sup> .....	\$202.0	\$213.2	\$186.3
U.S. Upper Market <sup>(2)</sup> .....	111.1	88.3	111.9
Europe .....	171.0	177.4	193.8
Socks <sup>(3)</sup> .....	83.9	89.4	144.2
Delta Marketing			
Israel <sup>(3)</sup> .....	34.8	37.6	46.5
Adjustments <sup>(4)</sup> .....	<u>(35.5)</u>	<u>(25.8)</u>	<u>(28.4)</u>
<b>Total</b>	<u>\$567.3</u>	<u>\$580.1</u>	<u>\$654.3</u>

- (1) 2004 sales include \$3.6 million for Burlen, which was acquired in the fourth quarter of 2004.
- (2) US Upper Market and the textile divisions were merged. Numbers included above have been reclassified accordingly.
- (3) Socks marketing operation in Israel was transferred to the managerial responsibility of Delta Marketing Israel. Numbers included above have been reclassified accordingly.
- (4) Adjustments include inter-segment sales and results of hedging transactions.

*Sales by Segment in 2004 vs. 2003*

The decrease in sales by Delta USA is attributed mainly to a decrease in sales to Wal-Mart and Target. The increase in sales by the U.S. Upper Market segment resulted primarily from an increase in sales to Calvin Klein and JC Penney. The increase in sales by the European segment is attributed to the strengthening of the pound sterling and the euro against the U.S. dollar as well as sales to new customers. The increase in sales by the Socks segment is attributed to the acquisition of European operation of Auburn. The increase in sales by the Israeli market segment is attributed mainly to different mix of products and to the opening of new stores.

*Sales by Segment in 2003 vs. 2002*

The increase in sales by Delta USA segment resulted primarily from an increase in sales to existing customers. The decrease in sales by the U.S. Upper Market segment resulted primarily from Delta Galil's decision to reduce the number of customers, as well as general weakness in this market, part of which is reflected in a decrease in sales to Victoria's Secret, this segment's largest customer. The increase in sales by the European segment is attributed to the strengthening of the pound sterling and the euro against the U.S. dollar. In pound sterling and euro terms, sales declined. The increase in sales by the Socks segment is attributed to the consolidation of Auburn in the fourth quarter of 2003.

**Operating Income (loss) by segment**

	<b><u>(\$ million)</u></b>		
	<b><u>2002</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>
Delta USA.....	\$14.6	\$24.8	\$5.9
U.S. Upper Market <sup>(1)</sup> ...	(4.7)	(8.9)	(0.6)
Europe <sup>(2)</sup> .....	10.2	4.4	4.9
Socks <sup>(3)</sup> .....	8.3	9.0	9.1
Delta Marketing			
Israel <sup>(3)</sup> .....	(1.3)	2.4	4.8
Adjustments and Capital			
Gains <sup>(4)</sup> .....	<u>0.7</u>	<u>5.1</u>	<u>(1.7)</u>
Total	<u>\$27.8</u>	<u>\$36.8</u>	<u>\$22.4</u>

- (1) In the beginning of 2005, US upper market and the textile divisions were merged. Numbers included above have been reclassified accordingly.
- (2) Operating profit in 2004 includes restructuring expenses relating to the closure of a logistic center in Hungary in the amount of \$1.5 million, \$1.0 million in 2003 for the closure of sewing facility in Scotland and in Israel, and \$0.7 million in 2002 for the closure of facilities in Scotland.
- (3) Socks marketing operation in Israel was transferred to the managerial responsibility of Delta Marketing Israel. Numbers included above have been reclassified accordingly.
- (4) Adjustments include mainly cancellation of unrealized profits and hedging transactions results. In 2003 adjustments include mainly capital gain from the sale of the real estate in London.

*Operating Income (loss) by Segment in 2004 vs. 2003*

The decrease in the operating income of Delta USA was due primarily to a decrease in sales and to losses from operations with certain customers. The decrease in the operating loss in the U.S. Upper Market segment is primarily due to an increase in sales volumes. The erosion in the operating margin in the Socks segment is attributed to the acquisition of Auburn, which contributed to an increase in sales, which had no substantial operating income. The increase in operating income in Delta Marketing Israel is attributed to the improvement of procurement sources and to increased in sales volumes.

*Operating income (loss) by Segment in 2003 vs. 2002*

The increase in operating income in Delta USA resulted from an increase in sales in 2003, as well as the write-off of doubtful accounts receivable from K-mart in 2002, which reduced operating income in 2002. The decrease in operating income in the U.S. Upper Market segment is primarily due to reduced sales volumes. The reduction in operating income was less than the reduction in sales due to the change in the mix of customers, towards sales to more profitable customers. The decline in operating income of the European segment, despite the favorable exchange rates, is due primarily to costs associated with the closure of a manufacturing and warehousing center in Scotland and the integration of a new logistics center in Hungary that replaced part of the Scottish operation. The increase in operating income of the Socks segment resulted primarily from the strengthening of the pound sterling and the euro against the U.S. dollar. The Adjustments in 2003 include mainly a capital gain from the sale of real estate in London.

*Year ended December 31, 2004 compared with Year Ended December 31, 2003 – Consolidated*

*Revenues.* Total revenues in 2004 increased by 12.8% and amounted to \$654.3 million compared to \$580.1 million in 2003. Excluding sales of Burlen, which was acquired in the fourth quarter of 2004, and Auburn, which was acquired in the fourth quarter of 2003, sales from continuing operations increased by 4.5%, reaching \$598.7 million in 2004 compared to \$573.0 million in 2003. The increase in revenues from continuing operations is due mainly to the strengthening of the pound sterling and the Euro against the US dollar and to the increase in sales in 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 2004 increased by 14.9% and amounted to \$533.0 million (81.5% of revenues) compared to \$463.9 million (80.0% of revenues) in 2003. Most of the increase in the cost of revenues is attributed to an increase in sales volume.

*Gross profit.* Gross profit in 2004 increased by 4.3% over 2003 and totaled \$121.2 million (18.5% of revenues), compared to \$116.3 million (20.0% of revenues) in 2003.

*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 24.2 % to \$ 81.2 million (12.4% of revenues) in 2004 compared to \$65.4 million (11.3% of revenues) in 2003. The increase in selling and marketing expenses is attributed mainly to the acquisition of Auburn, to a \$2.5 million increase in salaries and related expenses due to the strengthening of the pound sterling and the NIS versus the dollar, to a \$1.4 million increase in lease expenses mainly due to the strengthening of the pound sterling versus the dollar and to the increased activity in the Israeli market.

*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 increased from \$16.7 million in 2003 to \$17.4 million in 2004. The increase in general and administrative expenses is attributed mainly to the acquisition of Auburn.

*Capital gain (loss) from realization of fixed assets.* In 2004 Delta Galil recorded capital gain of \$0.9 million mainly from the sale of real estate in Ireland. In 2003 Delta Galil recorded a \$3.9 million capital gain from the sale of real estate in London, which was offset by \$0.3 million of capital loss from realization of other fixed assets.

*Goodwill amortization.* Based on FAS 142, which Delta Galil adopted on January 1, 2002, goodwill is no longer amortized. Prior to January 1, 2002 Delta Galil amortized goodwill in equal annual installments usually over a period of 40 years. See "Critical Accounting Policies - Valuation of Intangible Assets-Goodwill".

*Restructuring expenses.* Restructuring expenses in 2004 related to the closure of the logistic center in Hungary. In 2003 restructuring expenses related to the closure of sewing plants in Scotland and in Israel.

*Operating income.* Operating income in 2004 decreased by 39.1% compared to 2003 and totaled \$22.4 million (3.4% of revenues) compared to \$36.8 million (6.3% of revenues) in 2003. The decrease in the operating profit is primarily due to losses from operations with certain of Delta USA's customers, and to losses incurred from the operation of the logistic center in Hungary.

*Financial expenses – net.* Financial expenses increased by 10.5% to \$6.2 million in 2004 from \$5.6 million in 2003 mainly due to increased bank loans due to the acquisition of Auburn and to the increase in the average interest rate. Financial expenses were composed mainly of interest and exchange differences.

*Other income- net.* Other income in 2004 increased by \$0.7 million compared to 2003. 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.", while in 2003 a similar capital gain of \$0.9 million was offset by the write-off of other investments.

*Taxes on income.* Income taxes for 2004 were provided for at an effective tax rate of 16.6% compared to 23.4% in 2003. The decrease in the effective tax rate in 2004 compared to 2003 is mainly due to a decrease in pre-tax earnings of subsidiaries that are subject to higher tax rates.

*Share in losses of associated companies.* Delta Galil's share in losses of associated companies includes its investment in Edomit Ltd., which is accounted for by the equity method. In 2004 this share amounted to a loss of \$0.2 million compared to a loss of \$0.3 million in 2003.

*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 starting April 2003, also 10% of Delta Elastic Tapes, amounted to \$1.4 million in 2004 compared to \$0.4 million in 2003.

*Net Income.* Net income in 2004 decreased by 45.7% and totaled \$12.7 million (1.9% of sales) compared to \$23.4 million (4.0% of sales) in 2003.

*Year ended December 31, 2003 compared with Year Ended December 31, 2002 – Consolidated*

*Revenues.* Total revenues in 2003 increased by 2.3% and amounted to \$580.1 million compared to \$567.3 million in 2002. Sales in 2003 include \$7.1 million that resulted from the consolidation of Auburn Hosiery starting in November. Excluding these sales, the total sales in 2003 increased by 1% and amounted to \$573.0 million, compared to \$567.3 million in 2002. Revenues in North America decreased by 0.8% and amounted to \$300.7 million in 2003 compared to \$303.1 million in 2002. The decrease is attributed to a decrease in Delta's North America sales to specialty and department stores, which dropped 25% in 2003, totaling \$75.8 million, compared to \$101.1 million in 2002. This decrease was offset by the revenues from the US mass market, which increased 11.3% in 2003 totaling \$224.9 million, compared to \$202.0 million in 2002. The increase in revenues in the U.K. is attributed to the strengthening of the pound sterling against the US dollar. Revenues from the Israeli market increased by 11.2% from \$38.5 million in 2002 to \$42.8 million in 2003. The increase in revenues from the Israeli market resulted from the increase of Delta Plus retail chain stores activity reaching 79 stores, improved procurement sources, and the strengthening of the NIS versus the dollar. Delta Galil's sales to the European market increased by 9.7% to \$48.7 million in 2003 compared to \$44.4 million in 2002, mainly due to the strengthening of the euro versus the US dollar.

*Cost of revenues.* Cost of revenues in 2003 increased by 2.1% and amounted to \$463.9 million (80.0% of revenues) compared to \$454.2 million (80.1% of revenues) in 2002. While cost of work performed by sub-contractors increased by 25% compared to 2002, materials consumption and wages and salaries decreased by 14% and 6% respectively.

*Gross profit.* Gross profit in 2003 increased by 2.8% over 2002 and totaled \$116.3 million (20.0% of revenues), compared to \$113.1 million (19.9% of revenues) in 2002.

*Selling and marketing expenses.* Selling and marketing expenses increased by 4.3 % to \$ 65.4 million (11.3% of revenues) in 2003 compared to \$62.7 million (11.1% of revenues) in 2002. The increase in selling and marketing expenses is attributed mainly to a \$1.8 million increase in salaries and related expenses due to the strengthening of the pound sterling and the NIS versus the dollar and \$1.0 million increase in lease expenses due to the increase in the number of stores in the Israeli local retail chain and to the strengthening of the pound sterling versus the dollar.

*General and administrative expenses.* General and administrative expenses decreased from \$21.4 million in 2002 to \$16.7 million in 2003. The decrease in general and administrative expenses is attributed mainly to a decrease in provision for doubtful accounts receivable, which accounted for \$3.9 million of the decrease.

*Capital gain (loss) from realization of fixed assets.* In 2003 Delta Galil recorded a \$3.9 million capital gain from the sale of real estate in London, which was offset by \$0.3 million of capital loss from realization of other fixed assets, versus a loss of \$0.1 million in 2002.

*Restructuring expenses.* Restructuring expenses, which are comprised in large part of expenses relating to the closure of sewing plants, decreased from \$1.1 million in 2002 to \$1.0 million in 2003.

*Operating income.* Operating income in 2003 increased by 32.6% compared to 2002 and totaled \$36.8 million (6.3% of revenues) compared to \$27.8 million (4.9% of revenues) in 2002. The increase in



the operating profit margin is primarily due to the capital gain from the sale of the real estate in London and to the decrease in the general and administrative expenses as described above.

*Financial expenses – net.* Financial expenses increased by 3.3% to \$5.6 million in 2003 from \$5.5 million in 2002. Financial expenses are comprised mainly of interest and exchange differences.

*Other income- net.* Other income in 2003 decreased by \$0.7 million compared to 2002, and consists of a \$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”, offset by \$0.7 million impairment of other investments.

*Taxes on income.* Income taxes for 2003 were provided for at an effective tax rate of 23.4% compared to 24.8% in 2002. The decrease in the effective tax rate in 2003 compared to 2002 is mainly due to an increase in pre-tax earnings of subsidiaries that are subject to lower tax rates.

*Share in profits (losses) of associated companies.* Delta Galil’s share in profits (losses) of associated companies includes its investment in Edomit Ltd., which is accounted for by the equity method, and in 2002 also its investment in STE. In 2003 this share amounted to a loss of \$0.3 million in 2003 compared to a profit of \$0.2 million in 2002.

*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 in 2003 amounted to \$0.4 million compared to \$1.0 million in 2002. Starting April 2003, following the sale of 10% of Delta Galil’s holding in Delta Elastic Tapes, minority interest includes income of \$0.1 million relating to this activity.

*Net Income.* Net income in 2003 increased by 40.4% and totaled \$23.4 million (4.0% of sales) compared to \$16.6 million (2.9% of sales) in 2002.

### **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, Delta Galil has reviewed the selection and application of its critical accounting policies and financial disclosure as at December 31, 2004, 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 3 – Risk Factors.

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 in the specifics of the business 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 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.

### *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 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 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.

### *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, 2004, based on the review made by Delta Galil, no impairment was required.

### **New Accounting Standards under US GAAP**

#### FAS 151

In November 2004, the FASB issued FAS No. 151, “Inventory Costs – an amendment of ABV43, Chapter 4” (FAS 151). FAS 151 amends the guidance in ARB No. 43, Chapter 4, “Inventory Pricing,” to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. FAS 151 requires that those items be recognized as current-period charges. In addition, FAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. FAS 151 is required to be implemented by Delta Galil for inventory costs incurred during fiscal years beginning January 1, 2006, but earlier application of FAS 151 is permitted. The provisions of this Statement shall be applied prospectively. Delta Galil does not expect this Statement to have a material effect on its financial statements or its results of operations.

#### FAS 153

In December 2004, the FASB issued FAS No. 153, “Exchanges of Nonmonetary Assets-An Amendment of APB Opinion No. 29” (FAS 153). FAS 153 amends APB Opinion No. 29, “Accounting for

Nonmonetary Transactions” (Opinion 29). The amendments made by FAS 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the exception for nonmonetary exchanges of similar productive assets and replace it with a general exception for exchanges of nonmonetary asset that do not have commercial substance. The provisions in FAS 153 are effective for Delta Galil for nonmonetary asset exchanges occurring in fiscal periods beginning July 1, 2005. Early application of the FAS 153 is permitted. The provisions of this Statements shall be applied prospectively. Delta Galil does not expect the adoption of FAS 153 to have a material effect on its financial statements or its results of operations.

#### FAS 123R

In December 2004, the Financial Accounting Standards Board ("FASB") issued the revised Statement of Financial Accounting Standards ("FAS") No. 123, Share-Based Payment (FAS 123R), which addresses the accounting for share-based payment transactions in which a Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. FAS 123R eliminates the ability to account for employee share-based payment transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and requires instead that such transactions be accounted for using the grant-date fair value based method. FAS 123R will be effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 (July 1, 2005 for Delta Galil). Early adoption of FAS 123R is encouraged.

On April 15, 2005, the Securities and Exchange Commission approved a new rule, under which FAS 123R is effective for public companies at the beginning of their next fiscal year that begins after June 15, 2005 (January 1 of 2006 for Delta Galil). FAS 123R applies to all awards granted or modified after its effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the effective date of FAS 123R shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant-date fair value as previously calculated for the pro-forma disclosure under FAS 123R.

Delta Galil expects that upon the adoption of FAS 123R, it will apply the modified prospective application transition method, as permitted by FAS 123R. Under such transition method, upon the adoption of FAS 123R, Delta Galil financial statements for periods prior to the effective date of FAS 123R will not be restated. The impact in 2006 and beyond will depend upon various factors, among them Delta Galil's future compensation strategy.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB No. 107"). SAB No. 107 provides guidance on the initial implementation of FAS No. 123(R). In particular, the statement includes guidance related to share-based payment awards with non-employees, valuation methods and selecting underlying assumptions such as expected volatility and expected term. It also gives guidance on the classification of compensation expense associated with share-based payment awards and accounting for the income tax effects of share-based payment awards upon the adoption of FAS No. 123(R). The Company is currently assessing the guidance provided in SAB No. 107 in connection with the implementation of FAS No. 123(R).

Delta Galil does not expect FAS 123R to have a material effect on its results of operations in future periods.

#### FAS 154

In May 2005, the FASB issued FAS No. 154, "Accounting Changes and Error Corrections". FAS No. 154 is a replacement of Accounting Principles Board Opinion ("APB") No. 20 and FASB Statement No. 3. FAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. FAS No.154 also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The Statement carries forward the guidance contained in APB No. 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate.

FAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (January 1, 2006 for the Company). The Company does not expect this standard to have a material effect on the Company's financial statements or results of operations.

## 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.

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

	<b>Year ended December 31</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Net cash flow provided by operating activities .....	\$26.3	\$42.9	\$27.2
Net cash flow used in investing activities.....	(19.7)	(18.4)	(73.7)
Net cash flow provided by financing activities (excluding dividends to shareholders and cost of acquisition of treasury shares).....	10.5	(11.8)	59.1
Dividends to shareholders .....	(7.0)	(9.5)	(8.3)
Cost of acquisition of treasury shares.....	(8.4)	-	-
Translation differences on cash equivalents of foreign currency consolidated subsidiary.....	-	-	0.1
Increase in cash and cash equivalents.....	<u>\$1.7</u>	<u>\$3.2</u>	<u>\$4.4</u>

In 2002, 2003 and 2004 Delta Galil generated excess cash flow from operations of \$26.3 million, \$42.9 million and \$27.2 million respectively. The decrease in net cash flow provided by operating activities from \$42.9 million in 2003 to \$27.2 million in 2004 is mainly attributed to the decrease in net income. The increase in the net cash flow used in investing activities is mainly attributed to the acquisition of Burlen in the fourth quarter of 2004. Net cash flow used in financing activities in 2004 amounted to \$59.1 million while in 2003 the net cash flow provided by financing activities amounted to \$11.8 million. The decrease in cash flow used in financing activities is attributed mainly to the increase in bank debt in connection with the acquisition of Burlen.

### *Debt*

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

	<b>Year ended December 31</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Short-term:</b>			
Bank loans.....	\$96.4	\$94.5	\$55.6
Current maturities of long-term loans	<u>10.3</u>	<u>10.4</u>	<u>27.9</u>
Total Short-term.....	<u>106.7</u>	<u>104.9</u>	<u>83.5</u>
<b>Long-term:</b>			
Total Long-term bank loans.....	<u>23.0</u>	<u>13.6</u>	<u>98.4</u>
Total Debt.....	<u>\$129.7</u>	<u>\$118.5</u>	<u>\$181.9</u>

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 ranging from approximately 3.8% to 5.5% (mainly 3.8%) and are secured by liens on Delta Galil's assets. Delta Galil's bank loans are issued under secured bank lines of credit of up to \$332.4 million of which, as of December 31, 2004, Delta Galil had \$150.5 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. All of Delta Galil's short-term loans have maturities of up to three months. Part of Delta Galil's borrowings is for shorter periods in order to maintain cash management flexibility. Long-term bank loans mature in periods up to December 2009.

Delta Galil USA Inc. is a party to a credit agreement, which was amended as of December 2004, with Bank Leumi USA and Bank Hapoalim B.M. Borrowings under the credit agreement are secured by substantially all of the assets of Delta Galil USA Inc. The credit agreement provides for up to \$130 million in loans of which \$70 million are term loans and the remainder is revolving credit. The principal of the term loans are payable in 20 equal quarterly installment of approximately \$3.5 million each until December 1, 2009. As of December 31, 2004 \$15.2 million of this credit line was unutilized. Under this agreement Delta Galil USA is obliged to preserve certain financial covenants.

*Working Capital and Capital Expenditures*

Working capital at December 31, 2004 was \$127.4 million, compared to \$56.6 million at December 31, 2003. The increase is attributed to the acquisition of Burlen and to the decrease in short-term loans. Delta Galil believes that its working capital is sufficient for its present requirements. Delta Galil has no material commitment for capital expenditures, but is currently constructing a production facility in China in which it expects to invest approximately \$5.0 million in 2005.

Set forth below are our contractual obligations and other commercial commitments as of December 31, 2004:

<b>Contractual Obligations</b>	<b><u>Payments Due by Period</u></b>			
	<b><u>Total</u></b>	<b><u>Less than 1 year</u></b>	<b><u>2- 4 years</u></b>	<b><u>More than 5 years</u></b>
	<b>(U.S. \$ in millions)</b>			
Long-Term Debt (1) .....	\$137.9	\$32.1	\$82.8	\$23.0
Capital Lease Obligations.....	1.0	0.1	0.2	0.7
Operating Leases.....	43.3	7.6	19.1	16.6
Letter of credits and bank guarantees.....	<u>32.0</u>	<u>26.5</u>	<u>2.7</u>	<u>2.8</u>
Total Contractual Cash Obligations.....	<u>\$214.2</u>	<u>\$66.3</u>	<u>\$104.8</u>	<u>\$43.1</u>

(1) Includes expected interest expenses on long-term debt, based on interest rates in effect as of December 31, 2004.

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

## ITEM 6: DIRECTORS AND SENIOR MANAGEMENT AND EMPLOYEES

### Directors and Senior Management

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

<u>Name</u>	<u>Age</u>	<u>Position</u>
Dov Lautman	69	Chairman of the Board of Directors
Arnon Tiberg	61	President, Chief Executive Officer and General Manager
Yossi Hajaj	37	Senior Vice President & Chief Financial Officer
Aviram Lahav	46	Senior Vice President & CEO of US Upper Market Division
Michael Fitzgerald	62	Senior Vice President & Business Development USA
Imad Telhami	46	Senior Vice President & CEO of European Division
Esti Maoz	57	Senior Vice President & Global Development and Marketing
Eytan Stiassnie	49	Senior Vice President & CEO of Socks Division
Moshe Grencel	52	Senior Vice President - Supply Chain Management
David Kostman	40	Senior Vice President & CEO of Delta Galil USA
Aharon Dovrat	74	Director
Harvey M. Krueger	76	Director
Noam Lautman	36	Director
Giora Morag <sup>(1)(2)</sup>	60	Director
Amnon Neubach <sup>(1)(2)</sup>	60	Director
Dan Propper	64	Director
Zalman Shalev <sup>(2)</sup>	82	Director
Mark Silver <sup>(3)</sup>	34	Director
Amior Vinocourt <sup>(2)</sup>	78	Director
J. Randall White <sup>(3)</sup>	50	Director
Ann E. Ziegler <sup>(3)</sup>	47	Director

(1) External Director.

(2) Member of the Audit Committee.

(3) Mr. Mark Silver, Mr. J. Randall White and Mrs. Ann E. Ziegler are nominees of Sara Lee International Corporation pursuant to a Shareholders Agreement among Sara Lee 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. 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.

**Arnon Tiberg** has been the President and Chief Executive Officer of Delta Galil since 1996. Mr. Tiberg 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., Strauss-Elite Holding Ltd., Kali Insurance Agency Ltd., and The First International Bank of Israel Ltd. Mr. Tiberg is also a member of the Executive Council of the Association of Publicly Traded Companies (of The Tel Aviv Stock Exchange).

**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 is a member of the Investment Committee of Tel Aviv University.

**Aviram Lahav** has been Senior Vice President since 1997. He served as CEO of Delta Galil's Innerwear USA operations from March 2004, and was recently appointed as CEO of the newly created 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.).

**Michael Fitzgerald** Recently appointed Corporate Senior Vice President of Business Development responsible for creating growth opportunities across all divisions doing business in the USA. He served as CEO of Delta Galil USA from 1999 until April 1 2005 , and was named Senior Vice President of Delta Galil in 2002. Mr. Fitzgerald was formerly Chief Executive Officer of Wundies Industries from 1989 until the company was acquired by Delta Galil in 1999. Mr. Fitzgerald started with Wundies in 1974 as manager of the ladies underwear division. He became Vice President of Marketing in 1983. Between 1966 and 1974 Mr. Fitzgerald held various marketing posts at the Buick Division of General Motors, Allied Chemical Fibers Division, and the Coated Fabric Division of Occidental Petroleum. Mr. Fitzgerald holds a Bachelor of Arts Degree from Fordham University and an MBA from the Bernard Baruch College of the City University of New York.

**Imad 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 operation.

**Esti 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. 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.

**Eytan Stiassnie** has been Vice President and C.E.O. of Delta Galil's Socks Division since January 2002 and was named Senior Vice President of Delta Galil Industries in May 2004. He joined Delta Galil in 1989, serving as the manager of information technology for the Sock Division until 1993, when he became the production manager of the Sock Division, a position he held until 1997. From 1997 until 2001 he was operations manager of the Sock Division, and during 2001 he served as vice president of logistics in the Sock Division. Mr. Stiassnie holds a B. Sc. in Industrial Engineering, specializing in Information Technology, from the Technion, Israel Institute of Technology.

**Moshe Grencel** joined Delta Galil in 2004 as a Senior Vice President Supply Chain Management. From 2001 to 2004 he served as an Executive VP for Global Operations and Supply Chain of Lumen Ltd. a medical device company. From 1998 until 2000 he served as a General Manager of Elscint Industrial Solutions. In the sixteen years before that he held several managerial positions in Elscint Ltd. Mr. Grencel holds a B.Sc in industrial and management engineering from the Technion, Israel Institute of Technology.

**David Kostman** has served as Senior Vice President and Chief Executive Officer of Delta Galil USA since April 2005. From 2002 to 2004 he served as Chief Operating Officer of Delta Galil USA. From 2000 to 2002 he served as Chief Operating Officer of Verticalnet, Inc. (Nasdaq: VERT). Prior to that he was a Managing Director at Lehman Brothers' Investment Banking Division in New York where he worked from 1994 to 2000. Mr. Kostman worked at NM Rothschild's Investment Banking Division in London from 1992-1994. Mr. Kostman is a Director of NICE Systems Ltd. (Nasdaq: NICE) and of Utopy, Inc. He holds an MBA from Insead, Fontainebleau (France) and an LL.B. from Tel Aviv University Law School.

**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 Automatic Data Processing Inc., 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 and Beth Israel Medical Center (NY) and Continuum Health Partners.

**Noam Lautman** has been a Director of Delta Galil since October 2001. Mr. Lautman has been Director for New Ventures and Strategic Business Planning at Teva Pharmaceutical Industries Ltd since 2002. Mr. Lautman previously served in various managerial positions in several Israeli companies operating in the high-tech field. 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.

**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. 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, and Arelnet Ltd. (TASE: ARNT), a VOIP switch company; 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 1981. 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 Weizmann Institute and the Technion, Israel Institute of Technology, and Chairman of the Boards of Directors of various industrial companies.

**Zalman Shalev** has served as a Director of Delta Galil since 1988. Mr. Shalev is the former Chairman of the Board of Directors of ORT Israel and a Director of World ORT Union and Israel Technical Incubators. Mr. Shalev is also a member of the Israeli Chief Scientist Advisory Board. Mr. Shalev was a member of the Board of Directors of Leumi & Co. until 1998. From 1967 to 1987 Mr. Shalev served as a Director and President of Elisra Electronic Company. From 1962 to 1966 Mr. Shalev served as director of communication electronics of the Israel Defense Forces.

**Mark Silver** has been a director since June 2005. He has been Executive Director - Corporate Development of Sara Lee Corporation since October 2003. From July 2000 until October 2003, Mr. Silver was Chief Counsel - Mergers & Acquisitions of Sara Lee Corporation. Mr. Silver joined Sara Lee in 2000 after being an attorney with the law firm Kirkland & Ellis. Mr. Silver earned a Bachelor of Arts degree in political science from the University of Illinois and a J.D. from Harvard Law School.

**Amior Vinocourt** has served as a Director of Delta Galil since December 1996. Mr. Vinocourt was a Director of Industrial Building Corporation Ltd., of Ofis Textile Ltd. and Alliance Tyre (1992) Ltd. Until 1995, Mr. Vinocourt was a Director of Neshua Underwriting and Issuing Ltd. and, from 1994 to 1997 a Director of Bank Hapoalim Ltd. Mr. Vinocourt is a Chartered Accountant (F.C.A.) (England) and a Certified Public Accountant (Isr). From 1972 to 1993 Mr. Vinocourt was managing Director of Industrial Finance Corp. Ltd. and the Investment Company for Industrial Development in Israel Ltd.

**J. Randall White** has served as a Director of Delta Galil since September 2003. Mr. White has served as Vice President – Corporate Affairs for Sara Lee Corporation since 2001. He joined Sara Lee in 1988 and has served in a variety of executive capacities at Sara Lee. Mr. White is a trustee and former Chairman of the Board of Hubbard Street Dance Chicago, Vice President and a trustee of the Goodman Theatre, a member of the Board of Trustees of Ravinia Festival and a member of the Board of Advisors of Catalyst. Mr. White earned a Bachelor of Arts degree in economics and mathematics from Dartmouth College and a Master of Business Administration from Harvard Business School.



**Ann E. Ziegler** has served as a Director of Delta Galil since July 1998. Ms. Ziegler is a Senior Vice President for Sara Lee Corporation and CFO and SVP-Administration of Sara Lee Food and Beverage. From March 2003 to March 2005, Ms. Ziegler was CFO and SVP-Administration of Sara Lee Bakery Group and from October 2000 until March 2003, Ms. Ziegler was Senior Vice President – Corporate Development for Sara Lee Corporation. Ms. Ziegler joined Sara Lee in 1993 after being an associate with the law firm Skadden, Arps, Slate, Meagher & Flom. Ms. Ziegler serves on the Board of Directors of Unitrin Inc., Lifeline Theater and Chicago Shakespeare Theatre. Ms. Ziegler earned a Bachelor of Arts Degree from the College of William and Mary and a J.D. from the University of Chicago Law School.

### **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 Sara Lee, receive a fixed annual compensation of approximately \$8,200 for their services on the board of directors or on any committee thereof. In addition, a sum of approximately \$300 is paid for attending each Board meeting. In 2004, Delta Galil’s expenses for directors’ compensation amounted to a total of approximately \$97,000. 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, 2004.

	<b><u>Salaries, Directors’ Fees, Commissions and Bonuses</u></b>	<b><u>Pension, Retirement and Similar Benefits</u></b>
All directors and executive officers (consisting of 24 persons) .....	\$3.9 million	\$0.3 million

As of June 20, 2005, 707,713 options to purchase Delta Galil’s ordinary shares were outstanding to certain executive officers and key employees (consisting of 9 persons who were granted options). See “Stock Option Plans” below and note 10 of the notes to Delta Galil’s consolidated financial statements included in Item 18 of this annual report.

### **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 and until their respective successors are elected and qualified. 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.

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 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.

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.

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

Messrs. Giora Morag and Amnon Neubach serve as external directors of Delta Galil. Their terms expire on September 30, 2006 and December 16, 2006, respectively.

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 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, Shalev and Vinocourt, 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.

## Employees

As of December 31, 2004, Delta Galil employed approximately 14,200 employees of these, approximately 12,000 were engaged in production, and the remainder performed administrative, marketing, logistics and other functions.

The following table shows the geographical distribution of Delta Galil's employees, as of December 31, 2004:

<u>Country</u>	<u>Number of Employees</u>
Egypt	4,355
Israel	2,930
Jordan	2,452
Honduras	1,973
United States	1,015
Far East (mainly Thailand)	913
United Kingdom	220
Hungary	117
Canada	207
Other	<u>18</u>
Total	<u>14,200</u>

Following restructuring plans implemented by the Company during the first half of 2005, the number of employees in Israel has decreased to approximately 2,550 as of May 15, 2005.

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, these payments will be increased gradually until January 1, 2009 and the range will be 7.69% to 15.81% of wages, of which the employee contributes between 59% and 66%. 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.

In addition, some employees of Delta Galil's U.S. subsidiary are subject to a collective bargaining agreement.

## Share Ownership

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

## Stock Option Plans

Delta Galil has four stock option plans and has separately issued options to one executive. The total shares that may be issued upon exercise of all outstanding options represent approximately 9% of the outstanding share capital of Delta Galil after taking into account shares issuable upon exercise of these options, as of May 15, 2005. In May 1998, Delta Galil adopted an option plan to retain and attract qualified persons as employees and officers and to motivate such persons by providing them with an equity participation. The stock option plan is designed to afford the participants tax benefits under Section 102 of the Israeli Income Tax Ordinance.

Options issued under the stock option plan are to be held in trust by Investec Clali 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. Shares issued upon exercise of options will be held by the trustee until the option holder pays applicable taxes. Unexercised options are not entitled to a vote while held by the trustee.

Options granted under the stock option plan vest over a period of three years in four equal tranches, the first of which vested in August 1998. The options are subject to restrictions on transfer, sale or hypothecation. Options may only be exercised commencing on the date that is two years after the date such options vested and they expire five years after vesting. Restrictions on disposition of options lapse according to the terms of the stock option plan under which those options are granted.

As of December 31, 2004, Delta Galil had outstanding under this plan options to purchase up to 65,696 ordinary shares at an exercise price of \$8.297 per ordinary share, converted to NIS on the date of the exercise. The exercise price is equal to 90% of the Tel Aviv Stock Exchange closing price on the last day of trading prior to the board of directors' approval of the plan. All of these options were granted to executive officers of Delta Galil and its subsidiaries.

In addition, Delta Galil has granted to Arnon Tiberg, Delta Galil's President and Chief Executive Officer, options to acquire 100,000 ordinary shares. The options were approved by the board of directors and the audit committee in September 1998, and at a shareholders' meeting on October 14, 1998. The option's exercise price is \$7.90 per share converted to NIS on the date of the exercise. The exercise price is equal to 90% of the Tel Aviv Stock Exchange closing price on the last day of trading prior to the board of directors' approval of the plan. As of December 31, 2004 all of the said options are fully vested. As of December 31, 2004, Delta Galil had outstanding under this plan options to purchase up to 50,000 ordinary shares.

In June 2000, Delta Galil adopted a new stock option plan. Under the new plan, options to purchase 809,000 ordinary shares, including an additional 100,000 options to Arnon Tiberg, Delta Galil's President and Chief Executive Officer, will be granted to 70 employees. As of June 20, 2005, 121,875 options that were granted to 19 employees were forfeited, upon the termination of their employment. 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 Investec Clali 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.

In October 2002 Delta Galil adopted a fourth stock option plan, under which options to purchase up to 1,100,000 ordinary shares may be granted. Under the new plan, options to purchase up to 1,004,500 ordinary shares were granted to 97 employees, including an additional 100,000 options to Arnon Tiberg, Delta Galil's President and Chief Executive Officer. 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 Investec Clali 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. The options vest in four equal batches. The first, second, third and fourth batches will vest in November 2003, 2004, 2005 and 2006 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. 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 June 20, 2005 options to purchase an additional 75,750 shares remain available for grant under the plan. As of June 20, 2005, 120,250 options that were granted to fourteen employees were forfeited upon the termination of their employment.

As of June 20, 2005, 1,827,071 options to purchase Delta Galil's ordinary shares were outstanding to certain executive officers and key employees (consisting of 110 persons who were granted options).

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### Major Shareholders

The following table sets forth stock ownership information (including all ordinary shares represented by ADSs) as of June 26, 2005, 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 beneficially owns 1% or more of Delta Galil's outstanding ordinary shares.

<u>Name</u>	<u>Number of Ordinary Shares Beneficially Owned</u>	<u>Percent of Ordinary Shares Outstanding<sup>(1)</sup></u>
Dov Lautman <sup>(2)</sup>	4,644,993	24.8%
Sara Lee International Corporation	4,256,537	22.8%
Bank Leumi Le Israel Ltd	1,476,987	7.9%
Arnon Tiberg <sup>(3)</sup>	497,588	2.7%
Amior Vinocourt <sup>(4)</sup>	63,501	0.3%
Aharon Dovrat	20,050	0.05%
Harvey Krueger	5,000	0.03%

- (1) Based on 18,695,165 ordinary shares outstanding, excluding 1,206,802 ordinary shares held by the Company and excluding 45,882 ordinary shares held by a trustee in connection with Delta Galil's stock option plans.
- (2) 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.
- (3) Includes 439,150 shares held by Ha'lakukah Ha'Neeman (65) Ltd., a company controlled by Mr. Tiberg. Arnon Tiberg was also granted options to acquire 300,000 ordinary shares. Options to acquire 100,000 ordinary shares have an exercise price of \$7.90 per share converted to NIS on the date of the exercise, and vest in four equal tranches over three years commencing in November 1998, of them 50,000 have been exercised during 2003. Options to acquire an additional 100,000 ordinary shares have an exercise price of \$21.07 per share converted to NIS on the date of the exercise, and vest in four equal tranches over three years commencing in August 2000. All of these options are exercisable commencing on the date that is two years after the date such options vested and expire five years after vesting. 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. These options vest in equal tranches over four years commencing in November 2003, and expire three years after vesting. The first two tranches are not exercisable until November 2004.
- (4) Held through Vinocourt Achzakot Ltd., a company controlled by Mr. Vinocourt.

## 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 Sara Lee Corporation and Sara Lee International Corporation.

The shareholders agreement provides, among other things, that:

- Sara Lee International Corporation is entitled to nominate 30% of the members of Delta Galil’s board of directors, excluding independent directors, with fractions rounded up to the next whole number, and Mr. Lautman is entitled to nominate the remainder of the members of the board, excluding independent directors;
- Delta Galil may not issue, allot or grant options over or conversion rights into its unissued share capital without the prior consent of Sara Lee International Corporation unless as part of a pro rata distribution of fully paid up bonus shares; and
- New appointments of a chief executive officer of Delta Galil shall require the consent of Sara Lee International Corporation.

In addition, the Lautman Group and Sara Lee International Corporation 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 Sara Lee holds less than 18% of the equity rights of Delta Galil and (ii) the transfer by Sara Lee of its shares to a competitor of Delta Galil, which is defined as an entity engaged in the United States, Israel or Western Europe in the manufacture of socks and underwear, including pantyhose and hosiery but excluding brassieres.

In March 2004, Mr. Lautman sold 1,700,000 ordinary shares representing 9.2% of Delta Galil’s outstanding shares for an aggregate selling price of \$24.8 million. The price per share received by Mr. Lautman was 2% beneath the then-current market price.

In January 1998, Mr. Lautman purchased from Sara Lee ordinary shares representing 12.52% of Delta Galil’s then outstanding shares for an aggregate purchase price of \$10.3 million. The price per share paid by Mr. Lautman was 41.9% above the then-current market price.

As of June 20, 2005, the Lautman Group owned 24.8% and Sara Lee owns 22.8% of the outstanding ordinary shares of Delta Galil.

As of June 20, 2005, Delta Galil has 25 shareholders of record resident in the United States, accounting for 24.7% of the outstanding ordinary shares.

## Related Party Transactions

### *Sales to Sara Lee Affiliates*

Delta Galil derived 0.2% of its revenues in 2004 from sales to subsidiaries of Sara Lee that own or license brands, such as Dim and Playtex. Delta Galil believes that these sales were on terms no less favorable to Delta Galil than sales to other third parties.

See “Item 10: Additional Information—Approval of Related Party Transactions under Israeli Law.”

**ITEM 8: FINANCIAL INFORMATION**

**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:

<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<u>\$0.30</u>	<u>\$0.37</u>	<u>\$0.52</u>	<u>\$0.45</u>



## ITEM 9: 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 depository. 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 the TASE, and (ii) the high and low sales prices of the ADSs as reported on the Nasdaq since December 2000. 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.

	<u>Ordinary Shares</u>				<u>ADS</u> <u>Equivalents</u>	
	<u>High</u>		<u>Low</u>		<u>High</u>	<u>Low</u>
	<u>NIS</u>	<u>\$</u>	<u>NIS</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
<b>Year Ending December 31, 2000:</b>	101.57	24.98	48.05	11.71	25.19	11.75
<b>Year Ending December 31, 2001:</b>	59.18	14.38	33.33	7.64	14.63	7.58
<b>Year Ending December 31, 2002:</b>	49.35	10.99	32.89	6.76	10.83	6.69
<b>Year Ending December 31, 2003:</b>						
First Quarter .....	55.46	11.47	46.71	9.76	11.15	9.33
Second Quarter .....	62.60	14.45	51.14	10.98	13.67	10.81
Third Quarter .....	67.60	15.22	58.30	13.14	14.51	12.83
Fourth Quarter.....	76.80	17.19	64.12	14.53	16.97	14.37
<b>Year Ending December 31, 2004:</b>						
First Quarter .....	74.40	16.81	66.60	14.72	15.72	14.31
Second Quarter.....	72.60	16.14	66.60	14.72	16.15	13.91
Third Quarter .....	72.82	16.25	52.75	11.63	15.48	11.76
Fourth Quarter.....	55.10	12.34	40.20	9.19	12.65	9.35
<b>Most Recent six Months</b>						
December 2004 .....	46.27	10.70	40.53	9.28	10.82	9.41
January 2005 .....	48.38	11.05	42.86	9.74	11.20	9.90
February 2005 .....	48.19	11.01	45.47	10.44	11.35	10.50
March 2005 .....	47.80	11.04	38.92	8.89	11.16	9.14
April 2005 .....	40.69	9.32	39.51	9.05	9.62	8.84
May 2005 .....	41.67	9.53	36.18	8.26	9.81	8.20

As of June 23, 2005, the last reported price of the ordinary shares on the TASE was NIS 31.34 (\$6.92) and on June 22, 2005 the last reported price per ADS on Nasdaq was \$ 6.85. 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.

## ITEM 10: ADDITIONAL INFORMATION

### 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 objects 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 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.

### *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:

- 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
- 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 there in the Companies Law or the regulations promulgated thereunder provides an exemption for such a case:

- an Extraordinary Transaction between a public company and a controlling shareholder, including a private placement;
- an Extraordinary Transaction with a third party in which a controlling shareholder of the company has a personal interest;
- 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
- terms of service of directors, including exculpation, indemnification, 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 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 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.

## **Shareholder 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 ( $33\frac{1}{3}\%$ ) 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 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 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, 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**

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.

### **Material Contracts**

During 2004, Delta Galil completed the acquisition of Burlen Corporation. For a description of this acquisition see Item 4 "Informaiton on the Company - Recent Acquisitions".

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.”

During 2003, Delta Galil completed the acquisition of Auburn Hosiery Mills. For a description of this acquisition see Item 4: “Information on the Company – Recent Acquisitions.”

### **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.

### **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 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 2004 is 35%. This rate is currently scheduled to decrease as follows: in 2005-34%, 2006-32%, 2007 and onward-30% 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.

#### *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. 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 2005 of 34% (as mentioned above, gradually scheduled to be reduced to 30% in 2007), for a period

of seven 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 are exempt from income tax in the first two years.

Delta Galil first derived income from some of the abovementioned Approved Enterprises in 1999. In the said years, 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 - 2004, 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 Approved Enterprise programs, Delta Galil has received grants totaling \$ 1.6 million in 2002, \$ 1.1 million in 2003 and \$1.1 million in 2004. 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 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.

Delta Galil is a "Foreign Investors Company" ("FIC"), as defined by the Investment Law, and is entitled to 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. Unless extended, Benefits under the Investment Law are granted to enterprises seeking approval not later than January 1, 2005. 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), 5729-1969. We believe that we currently qualify as an Industrial Company, but no assurance can be given that we will continue to qualify as an Industrial Company.

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 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 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.

The tax basis of shares acquired prior to January 1, 2003, with respect of which the shareholders had been exempt 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.

Beginning January 1, 2005, 15% tax rate applies to real capital gains derived from a sale of Non-Israeli tradable shares subject to the limitations described above. A non-Israeli tradable shares are: shares traded in a recognized stock exchange outside of Israel, except for (a) Israeli companies shares; (b) non Israeli companies shares dually traded on both the Tel Aviv Stock Exchange and a foreign stock exchange or a regulated market outside of Israel. Concerning non-Israeli tradable shares that were purchased before January 1, 2005, a 35% tax rate applies to real capital gain derived from the sale of the shares, which attributed to the holding period up to December 31, 2004 and 15% to remainder of the capital gain. The total real capital gain is divided to the aforementioned periods on a linear basis.

#### *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 capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid by the subsidiary in its country of residence.

#### *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 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.

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 25%, 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.

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, 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, and persons who have directly, indirectly or constructively owned 10% or more of the outstanding voting shares of Delta Galil at any time during the twelve months preceding the date of this annual report or of a disposition of ADRs, ADSs, or ordinary shares). **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.**

As used herein, the term "U.S. Holder" signifies a holder of an ADR evidencing an ADS or of an ordinary share, who is a citizen or resident of the United States, or that is (i) a corporation or a 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 (B) one or more U.S. persons have the authority to control all of the trust's substantial decisions.

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. 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.

Any dividends paid by us to a US holder on the ordinary shares or ADSs will be treated as foreign source income and will be categorized as “passive income” or, in the case of certain US holders, “financial services income” for US foreign tax credit purposes. Under recently enacted legislation, for taxable years beginning January 1, 2007, dividend income generally will constitute “passive category income” or, in the case of certain US holders, “general category income”. Subject to the limitations in the Code, as modified by the US Treaty, a US holder may elect to claim a foreign tax credit against its US federal income tax liability for Israeli income tax withheld from dividends received in respect of ordinary shares or ADSs. The US Treasury has expressed concerns that parties to whom ADSs are released may be taking actions that are inconsistent with the claiming of foreign tax credit for US holders of ADSs. Accordingly, the discussion above regarding the creditability of the Israeli withholding tax on dividends could be affected by future actions that may be taken by the US Treasury. US holders who do not elect to claim the foreign tax credit may instead claim a deduction for Israeli income tax withheld, but only for a year in which the US holder elects to do so with respect to all foreign income taxes. A deduction does not reduce US tax on a dollar-for-dollar basis like a tax credit. The deduction, however, is not subject to the limitations applicable to foreign tax credits. The rules relating to the determination of the foreign tax credit are complex. Accordingly, if you are a US holder of ordinary shares or ADSs, you should consult your own tax advisor to determine whether and to what extent you would be entitled to the credit.

Certain US holders (including individuals) are eligible for reduced rates of US federal income tax (at a maximum rate of 15%) in respect of “qualified dividend income” received in taxable years beginning before January 1, 2009. For this purpose, qualified dividend income generally includes dividends paid by a non-US corporation if, among other things, the US holders meet certain minimum holding periods and the non-US 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-US corporation is eligible for the benefits of a comprehensive US income tax treaty (such as the US Treaty) which provides for the exchange of information. We currently believe that dividends paid with respect to our ordinary shares and ADSs, should constitute qualified dividend income for US federal income tax purposes. The United States Treasury and the IRS have announced their intention to promulgate rules pursuant to which holders of shares and ADSs, among others, will be permitted to rely on certifications from issuers to establish that dividends are treated as qualified dividend income. Each individual US holder of ordinary shares or ADSs is urged to consult his own tax advisor regarding the availability to him of the reduced dividend tax rate in light of his own particular situation and regarding the computations of his foreign tax credit limitation with respect to any qualified dividend income paid by us, as applicable.

#### *Foreign Tax Credit*

Any dividends paid by Delta Galil to a U.S. Holder with respect to the ADSs or ordinary shares will be generally treated as foreign source income for U.S. foreign tax credit purposes. Subject to the limitations set forth in the Code, as modified by the treaty concerning double taxation between the United States and Israel, U.S. Holders may elect to claim a foreign tax credit against the U.S. federal tax liability for Israeli income tax withheld from dividends received in respect of ADSs or ordinary shares. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received in respect of ADSs or ordinary shares if such U.S. Holder has not held the ADSs or ordinary shares for a minimum period or to the extent that such U.S. Holder is under an obligation to make certain related payments with respect to substantially similar or related property. The rules relating to the determination of the foreign tax credit are complex, and each U.S. Holder should consult with its tax advisor to determine whether and to what extent it is entitled to such credit. U.S. Holders who do not elect to claim a foreign tax credit may instead claim a deduction for Israeli income tax withheld, but only for a year in which the U.S. Holder does so with respect to all foreign income taxes.

#### *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 treaty concerning double taxation between the United States and Israel, gain from the sale or other disposition of ADSs or ordinary shares by a Holder who is a U.S. resident (for treaty purposes) 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 in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

#### *Passive Foreign Investment Company*

A non-US corporation will be classified as a Passive Foreign Investment Company (a "PFIC") for any taxable year if at least 75% of its gross income consists of passive income (such as dividends, interest, rents, royalties (other than rents or royalties derived in the active conduct of a trade or business and received from an unrelated person), or gains on the disposition or certain minority interests), or 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 currently believe that we were not a PFIC for the year ended December 31, 2004. However, this conclusion is a factual determination that must be made at the close of each year and is based on, among 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 US holder would suffer adverse tax consequences. These consequences may include having gains realized on the disposition of ordinary shares or ADSs treated as ordinary income rather than capital gains and being subject to punitive interest charges on certain dividends and on the proceeds of the sale or other disposition of the ordinary shares or ADSs. Furthermore, dividends paid by a PFIC are not eligible to be treated as "qualified dividend income" (as discussed above).

Application of the PFIC rules is complex. US holders should consult their own tax advisors regarding the potential application of the PFIC rules to the ownership of our ordinary shares or ADSs.

#### *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 US backup withholding at a current rate of 28%. 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. US persons who are required to establish their exempt status generally must provide IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-US holders generally will not be subject to US information reporting or backup withholding. However, such holders may be required to provide certification of non-US status (generally on IRS Form W-8BEN) in connection with payments received in the United States or through certain US-related financial intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a holder's US 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.

#### **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 450 Fifth Street, 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.

**ITEM 11: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET 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 2004, Delta Galil derived 31% of its revenues from customers in pound sterling, 8% of its revenue were in NIS, and 10% were in euros. More than 10% of Delta Galil's expenses were in NIS in 2004.

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 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, 2004, Delta Galil had not entered into hedging transactions. In 2004, Delta Galil carried out sales of the pound sterling and the Euro in the amount of \$72 million and \$8 million, respectively. The loss on these transactions amounted to \$2.3 million. \$1.7 million of that loss is reflected in revenues, and \$0.6 million, which reflects the ineffective portion of changes in the fair value is presented among financial expenses.

Based on current sales volumes, expenses and exchange rates, each one percent devaluation in pound sterling or euro against the dollar would result in a decrease of approximately \$1.4 million or \$0.4 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 would result in a decrease of \$0.3 million in yearly operating income, and a devaluation of the NIS would have the opposite effect. Delta Galil's bank debt generally is denominated in U.S. dollars, and, therefore, is not materially exposed to changes in currency exchange rates.

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 13 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**

*Disclosure controls and procedures.* Delta Galil's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of its disclosure controls and procedures within the 90 days prior to the date of filing of this Annual Report on Form 20-F. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that Delta Galil has in place appropriate controls and procedures designed to ensure that information required to be disclosed by Delta Galil in the reports it files or submits under the Securities Exchange Act of 1934, as amended, and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

*Internal controls.* Since the date of the evaluation described above, there have not been any significant changes in Delta Galil's internal controls or in other factors that could significantly affect those controls.

**ITEM 16:**

**ITEM 16A: AUDIT COMMITTEE FINANCIAL EXPERT**

The Board of Directors and the Audit Committee have determined that Amior Vinocourt is an independent director under the definition of independence under the rules of the Nasdaq National Market, and that Mr. Vinocourt is the financial expert serving on the Audit Committee of Delta Galil.

**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 to Pricewaterhouse Coopers during the last two fiscal years:

	<u>2003</u>	<u>2004</u>
Audit fees	\$385,660	\$383,000
Tax fees	<u>75,000</u>	<u>67,000</u>
Total	<u>\$460,660</u>	<u>\$450,000</u>

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 FOR AUDIT COMMITTEES.**

None

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

Not applicable.

**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-49 hereof.

**ITEM 19: EXHIBITS**

<b>(a) <u>Index to Consolidated Financial Statements</u></b>	<b><u>PAGE</u></b>
Report of Independent Registered Public Accounting Firm .....	F-2
Consolidated Statements of Income for the Years Ended December 31, 2002, 2003 and 2004 .....	F-3
Consolidated Balance Sheets at December 31, 2002 and 2003 .....	F-4
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2002, 2003 and 2004 .....	F-6
Consolidated Statements of Cash Flows for the Years Ended December 31, 2002, 2003 and 2004 .....	F-7
Notes to Consolidated Financial Statements .....	F-10
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Reports of Independent registered public accounting firms with respect to consolidated subsidiaries.....	F-52

  

<b>(b) <u>Exhibits</u></b>	
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 Related 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 Agreement for Purchase and Sale of Stock of Auburn Hosiery Mills, Inc. dated October 30, 2003, by and among Delta Galil USA Inc., Delta Galil Industries Ltd., Delta Galil Holland B.V., CGW Holdings, Inc., GCI Spainco, S.L. and Kellwood Company ****	
4.4 Option Plan to 13 employees of Delta Galil and/or its subsidiaries*	
4.5 Option Plan to Arnon Tiberg*	
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12.2 Section 302 Certification of Yossi Hajaj	
13.1 Section 906 Certification of Arnon Tiberg	
13.2 Section 906 Certification of Yossi Hajaj	

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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.

\*\* 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 with the Securities and Exchange Commission on June 23, 2004 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.

†Portions of this exhibit have been omitted and will be filed separately with the secretary of the Securities and Exchange Commission pursuant to a confidential treatment request.



**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: Yossi Hajaj

Name: Yossi Hajaj

Title: Chief Financial Officer

Date: June 27, 2005

EXHIBIT 4.1

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STOCK PURCHASE AGREEMENT

DATED AS OF

DECEMBER 8, 2004

BY AND AMONG

STEVEN KLEIN

KRISTINA NETTESHEIM

and

GARY BEGGS

AS SELLING SHAREHOLDERS

BURLEN CORP

AND

DELTA GALIL INDUSTRIES LTD.

and

DELTA GALIL USA, INC.

AS PURCHASER

RELATING TO THE ACQUISITION OF

BURLEN CORP.

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\*\* Represents material which has been redacted and will be separately filed with the Commission pursuant to a Request for Confidential Treatment pursuant to Rule 406 under the Securities Act of 1933, as amended.

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## STOCK PURCHASE AGREEMENT

This STOCK PURCHASE AGREEMENT, dated as of December 8, 2004 (the "Agreement"), by and among DELTA GALIL INDUSTRIES LTD., a company organized under the laws of the State of Israel ("Delta"), DELTA GALIL USA, INC., a Delaware corporation and a wholly owned subsidiary of Delta ("Purchaser"), BURLIN CORP., a Georgia corporation (the "Company" or "Burlin") and STEVEN KLEIN, KRISTINA NETTESHEIM and GARY BEGGS (the "Selling Shareholders").

### WITNESSETH

WHEREAS, the Company is engaged in the design, development, manufacture, importation, marketing, distribution, and sale of ladies' and girls' underwear, tops and sleepwear (the "Business"); and

WHEREAS, the Selling Shareholders wish to sell to the Purchaser, and the Purchaser wishes to purchase from the Selling Shareholders, all of the issued and outstanding shares of capital stock of the Company in exchange for the Purchase Price to be paid to such Selling Shareholders, on the terms and subject to the conditions set forth in this Agreement;

NOW, THEREFORE, in consideration of the mutual promises, representations, warranties, covenants and conditions set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound hereby, the Selling Shareholders and the Company, on the one hand, and the Purchaser and Delta, on the other hand, hereby agree as follows:

### ARTICLE I

#### SALE AND PURCHASE OF THE SHARES

1.1 Sale and Purchase of Company Capital Stock. Subject to the terms and conditions of this Agreement, at the Closing (as defined in Section 2.1) the Selling Shareholders shall sell to the Purchaser and the Purchaser shall purchase from the Selling Shareholders all the issued and outstanding capital stock of the Company (the "Company Capital Stock") in exchange for the Purchase Price. The "Purchase Price" shall be comprised of an aggregate amount equal to \$56,950,000 minus the Company's Net Debt (the "Closing Payment") plus the Performance Payment, if any, as defined in Section 1.4 below, which may be payable in 2006, 2007 and 2008 based on the Company's performance in 2005, 2006 and 2007. Any payments of the Purchase Price will be allocated among the Selling Shareholders in accordance with Section 2.2(c). As more fully described in Section 1.2 below, a portion of the Purchase Price shall be payable, at Delta's option, in the form of Ordinary Shares, par value NIS 1.00 per share, of Delta ("Ordinary Shares") and a portion shall be subject to an escrow agreement, as described in Section 1.3 hereof.

## 1.2 Calculation of Purchase Price.

(a) “Company Net Debt” shall mean (A) the sum of (i) the Company’s outstanding term loans under the credit facilities provided by or through Bank of America as of the Closing Date (the “Outstanding Term Loan”); and (ii) the Company’s outstanding revolving credit loans (but not including the face amount of any undrawn letters of credit issued as a sub-feature thereunder) under the credit facilities provided by or through Bank of America as of the Closing Date minus \$2,000,000; and (iii) any obligations of the Company with respect to amounts outstanding as of the Closing Date under the Industrial Development Revenue Bonds issued by the Tift County Development Authority for the benefit of the Company (the “IRB Debt”); and (iv) any interest that has accrued on the amounts referred to in (i), (ii), or (iii); and (v) the Company’s outstanding overdraft advances under the overdraft lines of credit made available to the Company, minus (B) the amount of cash and cash equivalents held by or in the name of the Company, as of the Closing Date; provided that for the purposes of this Agreement “Net Debt” shall not exceed the sum of the Outstanding Term Loan plus the IRB Debt plus \$4,500,000. For purposes of determining Company Net Debt, the parties shall rely exclusively on pay-off letters or other similar writings provided by the relevant lenders.

(b) Any Ordinary Shares of Delta to be issued pursuant to this Agreement will be valued at the average closing price of Delta’s Ordinary Shares on the Tel Aviv Stock Exchange for the thirty trading days ending on the third trading day prior to the date of the Closing or the date payment of the Performance Payments is due, as the case may be the “Fair Market Value”. For purposes of determining the number of Delta shares to be issued at the Closing and in respect of the payment of any portion of the Performance Payment, any amounts determined in US Dollars shall be converted into New Israeli Shekels, and any amounts determined in New Israeli Shekels shall be converted into U.S. Dollars, at the representative rate of exchange, as determined by the Bank of Israel, in effect on the relevant trading day.

(c) The Closing Payment shall be payable as follows: (i) an amount equal to \$54,700,000 minus the Company’s Net Debt shall be paid in cash (the “Cash Portion”) and (ii) the remaining amount to be paid at Closing may be satisfied, at Delta’s option, by either a cash payment or by the delivery of a number of the Ordinary Shares of Delta having a value equal to \$2,250,000 (the “Equity Portion”).

## 1.3 Indemnity Escrow.

As the exclusive security for the obligations of the Selling Shareholders pursuant to Section 7.9, 7.10 and 7.14 hereof, the sum of \$5,500,000 in cash (the “Indemnity Escrow”) shall be deposited with SunTrust Bank or another mutually acceptable escrow agent (the “Escrow Agent”) pursuant to the Escrow Agreement (in the form attached hereto as Exhibit 1.3) among the Purchaser, the Selling Shareholders and the Escrow Agent to be held by the Escrow Agent pursuant to the Escrow Agreement. As provided in the Escrow Agreement, the Indemnity Escrow will continue for ten years following the Closing (the “Escrow Period”) and a portion will be released

on each of the first three anniversaries of the Closing Date, *provided* that there are not any then-pending unresolved claims, as follows: (i) on the first anniversary, \$833,333.00 shall be released; (ii) on the second anniversary \$833,333.00 shall be released; (iii) on the third anniversary, \$833,334 shall be released; (iv) on the sixth anniversary, \$500,000 shall be released; and (v) on the tenth anniversary, the remainder of the Indemnity Escrow shall be released.

#### 1.4 Performance Payment.

(a) As used herein:

(i) “Net Sales” shall mean net sales, as determined under U.S. GAAP, for all sales by the Company to\*\*\*\*\*, in all cases determined consistent with revenue recognition methodologies employed for the fiscal year ending on December 31, 2004;

(ii) “EBIT” shall mean earnings before interest and taxes calculated as set forth in Annex 1 to this Agreement.

(iii) “Margin Minimum” shall mean EBIT as a percentage of Net Sales of at least \*\*\*% for the relevant period.

(b) In addition to the Closing Payment, the Selling Shareholders may be entitled to aggregate consideration in an amount not to exceed \$\*\*\*\*\* (the “Performance Payment”). A portion of the total Performance Payment shall be payable based on the attainment of performance targets for each of 2005, 2006, and 2007, as more fully described below. Any Performance Payment shall be made to the Selling Shareholders pro rata in proportion to their shareholdings in the Company as set forth on Schedule 2.2(c).

(c) Any payment of the Performance Payments shall be payable as follows: 75% in cash and 25% in either cash or Ordinary Shares of Delta at Delta’s discretion, subject to applicable restrictions on transfer, if any, to which the Ordinary Shares issuable at Closing are subject. In addition thereto and in connection with any such issuance, Delta shall make all such disclosures to the Selling Shareholders as may be required to be made in order to make the previous public statements not materially misleading. The number of Ordinary Shares issuable shall be calculated according to the Fair Market Value. Performance Payments shall be made by Purchaser to the Selling Shareholders within five (5) business days after Net Sales and EBIT for the applicable year are finally determined in accordance with Section 1.5. Notwithstanding anything in this Agreement to the contrary, Delta shall have no right to pay any portion of any amount owed to the Selling Shareholders (whether as part of the Closing Payment or Performance Payments) in Ordinary Shares unless at the time payment in Ordinary Shares is to be made the Ordinary Shares trade on the Tel Aviv Stock Exchange.

(d) If Net Sales in 2005 are \*\*\*\*\* (the “2005 Target Net Sales”) or more and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled collectively to a Performance Payment of \*\*\*\*\*. If Net Sales in 2005

are less than the 2005 Target Net Sales and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled to receive a share of the Performance Payment equal to:

\$\*\*\*\*\*

(e) If the Company's EBIT in 2005 is greater than or equal to \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate amount of \*\*\*\*\*. If the Company's EBIT in 2005 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*. If the Company's EBIT in 2005 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*.

(f) If Net Sales in 2006 are \*\*\*\*\*% of Net Sales in 2004 (the "2006 Target Net Sales") or more and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled collectively to a payment of \*\*\*\*\*. If Net Sales in 2006 are less than the 2006 Target Net Sales and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled to receive a share of the Performance Payment equal to:

\$\*\*\*\*\*

(g) If the Company's EBIT in 2006 is greater than or equal to \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*. If the Company's EBIT in 2006 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*. If the Company's EBIT in 2006 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*.

(h) If (I) the Selling Shareholders were not paid \$\*\*\*\*\* in the aggregate pursuant to application of the provisions of Section 1.4(d) of this Agreement and (II) if Net Sales for 2006 exceed the 2006 Target Net Sales (and the Margin Minimum was met or exceeded on such Net Sales for 2006), such excess of Net Sales for 2006 may be added to Net Sales for 2005 and the portion of the Performance Payment payable pursuant to application of the provisions of Section 1.4(d) of this Agreement shall be recalculated. The Selling Shareholders shall be entitled to payment of an amount equal to the difference between the recalculated aggregate amount of the Performance Payment payable to the Selling Shareholders as a result of such recalculation and the amounts previously paid in respect of application of the provisions of Section 1.4(d) of this Agreement. In no event shall the aggregate amount of the payments to be made to the Selling Shareholders pursuant to application of the provisions of Section 1.4(d), whether initially or upon any recalculation permitted pursuant to this Section 1.4(h), exceed \*\*\*\*\*. For the avoidance of doubt, any recalculation of the Performance Payment authorized to be made pursuant to this Section 1.4(h) shall not



include Net Sales for 2005 in the recalculation if the Margin Minimum for Net Sales for 2005 was not met.

(i) If Net Sales in 2007 are \*\*\*\*\*% of Net Sales in 2004 (“2007 Target Net Sales”) or more and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled collectively to a payment of \*\*\*\*\*. If Net Sales in 2007 are less than the 2007 Target Net Sales, and the Margin Minimum is met or exceeded, then the Selling Shareholders shall be entitled to receive a share of the Performance Payment equal to:

\$\*\*\*\*\*

(j) If the Company’s EBIT in 2007 is greater than or equal to \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*. If the Company’s EBIT in 2007 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*. If the Company’s EBIT in 2007 is greater than or equal to \$\*\*\*\*\* but less than \$\*\*\*\*\*, the Selling Shareholders shall be entitled to receive collectively an aggregate of \*\*\*\*\*.

(k) If the Selling Shareholders were not paid \$\*\*\*\*\* in the aggregate pursuant to application of the provisions of Section 1.4(d) of this Agreement (whether (A) initially or upon recalculation pursuant to Section 1.4(h) of this Agreement or (B) pursuant to application of the provisions of Section 1.4(f) of this Agreement), recalculations of the amounts of the portion of the Performance Payment payable to the Selling Shareholders pursuant to application of each of such Sections shall be made in accordance with the further provisions of this Section 1.4(k). If Net Sales for 2007 exceed the 2007 Target Net Sales (and the Margin Minimum is met or exceeded), such excess of Net Sales for 2007 shall be added first to Net Sales for 2005 to recalculate the Performance Payment payable in respect of 2005 Target Net Sales. Any such recalculation shall give effect to any prior recalculation made pursuant to Section 1.4(h) of this Agreement. The Selling Shareholders shall be entitled to payment of an amount equal to the difference between the recalculated aggregate amount of the Performance Payment payable to the Selling Shareholders as a result of such recalculation and the amounts previously paid in respect of application of the provisions of Section 1.4(d) of this Agreement. In no event shall the aggregate of the payments to be made to the Selling Shareholders pursuant to application of the provisions of Section 1.4(d), whether initially or upon any recalculation permitted pursuant to either of Sections 1.4(h) or 1.4(k) of this Agreement exceed \*\*\*\*\*. If Net Sales for 2005 as recalculated pursuant to application of this Section 1.4(k) results in the Selling Shareholders receiving, in the aggregate, \$\*\*\*\*\* in respect of the application of Section 1.4(d) of this Agreement and (A) there is an excess of Net Sales for 2007 over 2007 Target Net Sales, then (B) the amount of the excess in the foregoing clause (A) not used to adjust Burlen’s Net Sales for 2005 to an amount necessary to permit the payment of the maximum portion of the Performance Payment payable pursuant to Section 1.4(d) of this Agreement, shall be added to the amount of Net Sales for 2006 pursuant to Section 1.4(f) of this Agreement and the amount of the Performance Payment payable to the Selling Shareholders

thereunder recalculated. The Selling Shareholders shall be entitled to payment of an amount equal to the difference between the recalculated aggregate amount of the Performance Payment payable to the Selling Shareholders as a result of such recalculation and the amounts previously paid in respect of application of the provisions of Section 1.4(f) of this Agreement. In no event shall the aggregate of the payments to be made to the Selling Shareholders pursuant to application of the provisions of Section 1.4(f), whether initially or upon any recalculation permitted pursuant to this Section 1.4(k) exceed \*\*\*\*\*. For the avoidance of doubt, any recalculation of the Performance Payment authorized to be made pursuant to this Section 1.4(k) shall not include Net Sales for 2005 or Net Sales for 2006, as applicable, in the recalculation if the Margin Minimum for Net Sales for 2005 or Net Sales for 2006, as applicable, was not met.

(l) Notwithstanding anything in this Section 1.4 to the contrary or otherwise in this Agreement, if the employment of any Selling Shareholder with Burlen is terminated by Burlen without "Cause" (as such term is defined in such Selling Shareholder's Employment Agreement to be entered into in connection with the transactions contemplated hereby (the "Employment Agreement")) or if any Selling Shareholder terminates his or her employment "For Good Reason" (as such term is defined in the relevant Employment Agreement), and provided that EBIT for the full 12-month period ending on the calendar month prior to the effective date of any such termination are not lower than \$\*\*\*\*\* for 2004, Delta shall pay the Selling Shareholders an amount equal to (A) \$\*\*\*\*\* minus (B) (i) the aggregate amount of any Performance Payments previously made by Delta to the Selling Shareholders, and (ii) any Performance Payments not earned for prior years due to failure to meet the targets set forth above, such payment upon such termination being in full satisfaction of the Performance Payment.

#### 1.5 Performance Payment Calculations.

(a) For purposes of calculations and other determinations under Section 1.4 hereof, within 45 days after the end of the fiscal year in question, Delta shall cause to be prepared and shall deliver to the Selling Shareholders a preliminary statement setting forth in reasonable detail relevant calculations and other determinations for such fiscal year, along with supporting schedules, analyses, working papers and other documentation (collectively, the "Statement").

(b) During the 30-day period following receipt of the Statement (the "Review Period"), the Selling Shareholders shall be permitted reasonable access to the books and records of the Company relating to the Statement. If, within 30 days after delivery of the Statement, the Selling Shareholders allege that the Statement has not been prepared in accordance with this Agreement or that the Statement contains a mathematical mistake or other error, the Selling Shareholders shall deliver to Delta within such period a written notice (the "Notice of Disagreement") specifying in reasonable detail all disputed items and the basis therefor (collectively, the "Disputed Items"), and including, if necessary to provide reasonable detail, supporting schedules, analyses, working papers and other documentation. The failure by the Selling Shareholders to provide a Notice of

Disagreement to the Corporation within such 30-day period will constitute the acceptance by the Selling Shareholders of the Statement, and in such event the calculations and other determinations set forth on the Statement shall be the final calculations and other determinations for the fiscal year in question.

(c) During the 15-day period following the delivery of any Notice of Disagreement or such longer period as the Selling Shareholders and Delta shall mutually agree, the Selling Shareholders and Delta shall seek in good faith to resolve in writing any differences that they may have with respect to the matters specified in such Notice of Disagreement. If, at the end of such 15-day period (or such longer period as mutually agreed), the Selling Shareholders and Delta have not so resolved such differences, the Selling Shareholders and Delta shall submit the dispute for resolution to an independent accounting firm (the “Arbiter”) for review and resolution of any and all matters that remain in dispute and that were included in the applicable Notice of Disagreement. The Arbiter shall be a mutually acceptable internationally recognized independent public accounting firm agreed upon by the Selling Shareholders and Delta in writing; provided, that in the event the parties are not able to mutually agree on an accounting firm, the Arbiter shall be the New York, New York office of Ernst & Young. The Selling Shareholders and Delta shall use reasonable efforts to cause the Arbiter to render a decision resolving the matters in dispute within 30 days following the submission of such matters to the Arbiter, or such longer period as the Selling Shareholders and Delta shall mutually agree. The Arbiter shall determine, based solely on presentations by the Selling Shareholders and Delta and their respective representatives, and not by independent review, (except as provided in the proviso to this sentence), only those issues in dispute specifically set forth in the applicable Notice of Disagreement and shall render a written report as to the dispute and the resulting calculations, which shall be conclusive and binding upon the parties; provided, however, that upon request by the Selling Shareholders, the Arbiter shall do an independent audit of the books and records of Delta and its Subsidiaries (including the Company) and such other information deemed reasonably necessary by the Arbiter in order for the Arbiter to make its determination under this Section 1.5, in which case Delta shall provide the Arbiter with reasonable access to such books and records and other such information reasonably requested by the Arbiter. In resolving any Disputed Item, the Arbiter shall be bound by the principles set forth in this Agreement. The Arbiter shall notify the Selling Shareholders and Delta of its determination of the Disputed Items, which determination (each a, “Determination”) shall be final and binding on the parties hereto and shall be the sole and exclusive remedy of the parties hereto regarding such Disputed Items. Notwithstanding the foregoing, the Arbiter shall only consider and shall only have authority to resolve those accounting matters specifically referred to it for resolution. Any disagreements among the Selling Shareholders and Delta with respect to matters of law or the interpretation of this Agreement or any other agreement between the parties may be submitted to a court of competent jurisdiction/arbitration as provided in Section 10.14, and the Arbiter shall have no authority to decide such matters unless specifically agreed to by the Selling Shareholders and Delta. Any dispute as to whether a matter is an accounting matter or a matter of law or interpretation will, unless otherwise agreed by the parties at the time, be submitted to a court of competent jurisdiction/arbitration as provided in Section 10.14.

(d) If there shall not have been any Notice of Disagreement, Purchaser shall pay the Performance Payment (if any) to the Selling Shareholders no later than April 1 of the year following the year in respect of which the Performance Payment is payable. If there shall have been a Notice of Disagreement, Purchaser shall pay to the Selling Shareholders by April 1 of such year 50% of any Performance Payment set forth on the Statement, with the balance payable within 15 days following the resolution of any disputed amounts.

(e) Each party shall bear its own costs and attorney's fees incurred in connection with the process described by this Section 1.5, and shall share equally in the fees and expenses of the Arbiter; provided, however, that the Arbiter will be entitled to make a determination, which determination shall be final and binding on all parties, that one party pay all or part of the fees and expenses of the other party in connection with the process described by this Section 1.5.

## ARTICLE II

### CLOSING

2.1 Closing Date. The closing of the purchase and sale of the Company Capital Stock (the "Closing") shall take place at the offices of Kilpatrick Stockton LLP, 1100 Peachtree Street, Suite 2800, Atlanta, GA 30309, or at such other place as the parties may mutually agree, on December 8, 2004 (the "Closing Date"). For all purposes of this Agreement, the transactions contemplated hereby and provided for herein shall be effective as of 11:59:59 pm, EST, on December 8, 2004.

2.2 Deliveries.

(a) At the Closing, subject to the provisions of this Agreement, the Selling Shareholders shall deliver to the Purchaser, free and clear of all liens, the certificates for the shares of the Company Capital Stock, duly endorsed in blank, or with separate stock transfer powers attached thereto and signed in blank, with appropriate transfer stamps, if any, affixed thereto.

(b) At the Closing, the Company and the Selling Shareholders will make available to the Purchaser the written resignations of all the directors of the Company and its Subsidiaries (other than Steven Klein) effective as of the Closing and shall use reasonable efforts to cause to be made available to the successor directors and officers all minute books, stock record books, books of account, corporate seals, contracts and other documents, instruments and papers belonging to the Company and shall use best efforts to cause full possession and control of all of the Company assets and of all other things and matters pertaining to the operation of the Business to be transferred and delivered to the directors and officers elected to succeed the resigned directors and officers of the Company. At the Closing, the Company and Selling Shareholders shall also deliver to the Purchaser, and the Purchaser and Delta shall deliver to the Selling Shareholders, the certificates, opinions and other instruments, agreements and documents referred to in Sections 8.1, 8.2 and 8.3.

(c) At the Closing, Purchaser will deliver to each of the Selling Shareholders a pro rata portion of the Closing Payment in proportion to their shareholdings in the Company as set forth on Schedule 2.2(c). The portion of the Purchase Price payable in cash shall be delivered to each of the Selling Shareholders by wire transfer in immediately available funds to such account as each of the Selling Shareholders shall direct. The portion of the Purchase Price payable in the Ordinary Shares, if any, shall be delivered in the form of stock certificates representing the number of Ordinary Shares representing each Selling Shareholder's pro rata share of \$2,500,000, such number of shares to be calculated at the Fair Market Value of the Ordinary Shares.

2.3 No Fractional Shares. No fractional Ordinary Shares shall be issued to the Selling Shareholders pursuant to this Agreement. In lieu of the issuance of any such fractional Ordinary Shares pursuant to this Agreement, cash adjustments will be paid to holders in respect of any fractional Ordinary Shares of Delta that would otherwise be issuable.

2.4 Compliance with Israeli Securities Regulations; Restrictions on Resale.

(a) Each of the Company and the Selling Shareholders hereby acknowledges that, the issuance of the Ordinary Shares to the Selling Shareholders may require the approval by the Israeli Securities Authority (the "ISA"), the Tel Aviv Stock Exchange ("TASE") and other authorities administering Israeli corporate and securities regulations (the ISA, the TASE, along with such other authorities, the "Israeli Corporate and Securities Authorities") of certain filings required in connection with the transactions contemplated hereby and the issuance of the Ordinary Shares. In connection with the foregoing, each of the Company and the Selling Shareholders agrees to provide Delta (and its financial advisors, attorneys, accountants, consultants and other representatives) with all information reasonably requested by Delta for Delta to comply with such Israeli corporate and securities laws; provided, that the Company and the Selling Shareholders shall have no obligation under this Section 2.4(a) after Closing.

(b) Each of the Selling Shareholders hereby acknowledges and agrees that, the Ordinary Shares may be subject to certain restrictions on resale and other restrictions under Israeli and United States securities laws and regulations with respect to effecting any transactions in the Ordinary Shares and each of the Selling Shareholders hereby agrees to comply with such restrictions and regulations, if applicable.

### **ARTICLE III**

#### **REPRESENTATIONS AND WARRANTIES OF DELTA AND PURCHASER**

Delta and Purchaser, jointly and severally, represent and warrant to the Selling Shareholders and the Company, as of the date hereof and as of the Closing Date, as follows:

### 3.1 Organization.

(a) Each of Delta and Purchaser have been duly incorporated and are validly existing as corporations in good standing under the laws of their respective jurisdictions of organization and each such corporation has all the requisite corporate power and authority to own, lease and operate its properties and to carry on its business as it is now being conducted. Each of Delta and Purchaser is duly qualified or licensed to carry on its business as it is now being conducted, and is qualified to do business in each jurisdiction where the character of its properties owned or the nature of its activities makes such qualification necessary, except where the failure to be so qualified will not in the aggregate have a Material Adverse Effect. As used in this Agreement, the term “Material Adverse Effect” means, with respect to Delta, Purchaser or the Company, as the case may be, a material adverse effect on the business, assets, results of operations or financial condition of such corporation and its Subsidiaries taken as a whole or on such corporation’s ability to consummate the transactions contemplated hereby or in such corporation’s ability to conduct its business as currently being conducted or to perform its obligations hereunder.

(b) Neither Delta nor Purchaser is in violation of any provision of its Certificate of Incorporation or By-laws or similar organizational document that would have a Material Adverse Effect.

### 3.2 Capitalization.

(a) As of the date hereof, the authorized capital stock of Delta consists, in its entirety, of 26,000,000 Ordinary Shares, of which there are 19,947,849 Ordinary Shares issued and outstanding, including 1,422,486 Ordinary Shares owned by Delta, and 45,882 Ordinary Shares held by a trustee in connection with Delta’s stock option plans. As of the date hereof, 1,137,520 Ordinary Shares are reserved for issuance upon exercise of outstanding options pursuant to Delta’s employee stock option plans. All of the issued and outstanding Ordinary Shares are validly issued, fully paid, non-assessable and free of preemptive rights or similar rights created by statute, the Articles of Association or Memorandum of Association of Delta or any agreement to which Delta or any of its Subsidiaries is a party or by which Delta or any of its Subsidiaries is bound.

(b) Delta owns all of the outstanding shares of capital stock of Purchaser.

3.3 Authority Relative to This Agreement. Each of Delta and Purchaser has the requisite corporate power and authority to enter into this Agreement, Escrow Agreement (in the form attached hereto as Exhibit 1.3), and the other documents contemplated hereby to the extent that it is a party thereto (collectively, the “Delta Transaction Documents”), and to carry out its obligations hereunder and thereunder. The execution and delivery of the Delta Transaction Documents by Delta and Purchaser and the consummation by Delta and Purchaser of the transactions contemplated thereby and hereby have been duly authorized by the respective Boards of Directors of Delta and Purchaser, and by Delta as the sole shareholder of Purchaser and, except for the approval of the Israeli Corporate and Securities Authorities as set forth in Section 2.4, no other

corporate proceedings on the part of Delta or Purchaser are necessary to approve the Delta Transaction Documents or the transactions contemplated thereby. The Delta Transaction Documents have been duly and validly executed and delivered by each of Delta and Purchaser and each constitutes a valid and binding agreement of each of Delta and Purchaser, enforceable against Delta and Purchaser in accordance with its terms, except to the extent that enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and similar laws now or hereafter in effect relating to creditors' rights generally or by general principles of equity (regardless of whether enforceability is considered in a proceeding at law or in equity).

3.4 Consents and Approvals; No Violations. Except as disclosed on Schedule 3.4 hereto, and except for the applicable requirements of the DGCL, the Securities Act of 1933, as amended (the "Securities Act" or "1933 Act"), state securities or blue sky laws of the various states of the United States, Israeli corporate and securities laws and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "H-S-R Act"), no material filing with, and no material permit, authorization, consent or approval of, any public or governmental body or authority is necessary for the consummation by Delta and Purchaser of the transactions contemplated by the Delta Transaction Documents. Except as disclosed on Schedule 3.4 hereto, neither the execution and delivery of the Delta Transaction Documents by Delta or Purchaser, nor the consummation by Delta or Purchaser of the transactions contemplated thereby, nor compliance by Delta or Purchaser with any of the provisions thereof, will (a) conflict with or result in any breach of any provision of the Articles of Association or Memorandum of Association of Delta or the Certificate of Incorporation of Purchaser, (b) violate any order, writ, injunction, decree, statute, rule or regulation, in each case that is material, of any court or federal, state, local or foreign body or authority, or any nongovernmental self-regulatory organization or agency to which Delta, its Subsidiaries, or any of their properties or assets may be subject except for violations or breaches which would not in the aggregate have a Material Adverse Effect, or (c) result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default under, result in the loss of any material benefit under or give rise to any right of termination, cancellation, acceleration or change in the award, grant, vesting or determination under, or result in the creation of any lien, charge, security interest or encumbrance upon any of the respective properties or assets of Delta or any of its Subsidiaries, under, any of the terms, conditions or provisions of any note, bond, mortgage, indenture, deed of trust, license, contract, lease, agreement, arrangement or other instrument or obligation, in each case that is material, to which Delta or any of its Subsidiaries is a party or by which Delta or any of its Subsidiaries or any of their respective properties or assets may be bound or affected.

3.5 Reports and Financial Statements. Delta has filed all forms, reports, registration statements and documents required to be filed by it with the Securities and Exchange Commission ("SEC"), the securities division of any state of the United States, the ISA, and the TASE for the three year period preceding the Closing Date, and has heretofore delivered or made available to the Company, in the form filed with the SEC, (i) its Annual Report on Form 20-F for the fiscal year ended December 31, 2003, (ii) all proxy statements, if any, relating to Delta's meetings of shareholders (whether annual or special) held since January 1, 2004 and (iii) all other forms, reports and other registration

statements filed by Delta on Form 6-K with the SEC since January 1, 2004 (such forms, reports, registration statements and documents, together with any amendments thereto, are referred to as the “Delta SEC Filings”). As of their respective dates, (A) the Delta SEC Filings complied as to form and substance in all material respects with the applicable requirements of the 1933 Act and the Securities Exchange Act of 1934, as amended (the “Exchange Act” or “1934 Act”) as the case may be, and (B) none of the Delta SEC Filings contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements made therein, in light of the circumstances under which they were made, not misleading.

3.6 Delta Ordinary Shares. The Ordinary Shares to be issued hereunder, when issued and delivered to the Selling Shareholders pursuant to this Agreement, will be duly authorized, validly issued and outstanding, fully paid and non-assessable, and free and clear of all liens, charges, encumbrances and preemptive rights.

3.7 Brokers. Except as set forth on Schedule 3.7, none of Delta or Purchaser or any of its Subsidiaries is obligated to pay any financial advisor, broker or investment banker in connection with the transactions contemplated by this Agreement.

3.8 No Material Misrepresentations or Omissions. To the Knowledge of Delta and Purchaser, all information provided or to be provided in writing by or on behalf of either of Delta or the Purchaser, is or will be materially true and correct as of the date set forth in such written information and does not and will not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements made therein, and in light of the circumstances under which they were made, is not misleading as of the date set forth in such written information.

## ARTICLE IV

### REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company and the Selling Shareholders represent and warrant to Delta and Purchaser as of the date hereof and as of the Closing Date as follows:

4.1 Organization. Each of the Company and its Subsidiaries is a corporation duly organized, validly existing and in good standing under the laws of its state or country of incorporation or organization, which are set forth on Schedule 4.1 hereto, and each of the Company and its Subsidiaries has all the requisite corporate power and authority to own, lease and operate its properties and to carry on its business as it is now being conducted. Each of the Company’s Subsidiaries, direct and indirect, is listed on Schedule 4.1 hereto (the “Subsidiaries” and for purposes of this Agreement, any reference to the Subsidiaries of an entity shall be deemed to include all of the entity’s Subsidiaries directly or indirectly held). Each of the Company and its Subsidiaries is duly qualified or licensed to carry on its business as it is now being conducted, and is in good standing in each jurisdiction listed under such company’s name on Schedule 4.1 hereto, which jurisdictions so listed are all the jurisdictions where the character of its properties owned or the nature of its activities makes such qualification necessary, except



where the failure to be so qualified will not in the aggregate have a Material Adverse Effect, provided, that such exception shall not apply to the failure to so qualify in the State of New York. Schedule 4.1 hereto also sets forth the percentage of each of the Company's Subsidiaries' outstanding shares of capital stock or other equity interests owned by the Company and its Subsidiaries, as the case may be, and lists the directors and officers of each Subsidiary. Except as set forth on Schedule 4.1, there are no partnerships or joint venture arrangements or other business entities in which the Company or any of its Subsidiaries owns an equity interest. Except as set forth in Schedule 4.1 hereto, the Company is not party to, nor is the Company aware of the existence of, any voting trusts, shareholder agreements, proxies or other agreements or understandings in effect with respect to the voting or transfer of any shares of capital stock of or any other interests of the Company or its Subsidiaries.

4.2 Articles of Incorporation and Bylaws. The Company has heretofore furnished to the Purchaser a complete and correct copy of the Articles of Incorporation and Bylaws (or equivalent organizational documents), each as amended to such date, of the Company and each of its Subsidiaries. Such Certificates of Incorporation and Bylaws (or equivalent organizational documents) are in full force and effect. Neither the Company nor any of its Subsidiaries is in violation of any of the provisions of its Articles of Incorporation or Bylaws (or equivalent organizational documents).

4.3 Capitalization. Set forth on Schedule 4.3 hereto is the authorized and outstanding capital stock of the Company and each of its Subsidiaries. All of the issued and outstanding shares of Company Capital Stock and of the capital stock of each Subsidiary of the Company are validly issued, fully paid, non-assessable and free of preemptive rights or similar rights created by statute, the Articles of Incorporation or Bylaws of the Company or any agreement to which the Company is a party or by which the Company is bound. Schedule 4.3 hereto lists all the holders of Company Capital Stock and the amount of shares of Company Capital Stock held by each. There are no options, warrants, subscriptions, calls, claims, rights, convertible securities or other agreements or commitments obligating the Company to issue, sell or transfer any securities, whether written or oral (collectively, "Stock Equivalents"), outstanding as of the date hereof. Except as set forth on Schedule 4.3 hereto, there are no outstanding contractual obligations of the Company or any of its Subsidiaries to repurchase, redeem or otherwise acquire any capital stock of any of the Company's Subsidiaries or to provide funds to, or make any investment (in the form of a loan, capital contribution or otherwise) in, any of the Company's Subsidiaries or any other person. There are no shareholders' agreements, voting trusts or other agreements, arrangements or understandings applicable to the exercise of voting or any other rights with respect to any of the share capital of the Company. The Company Capital Stock was not issued in violation of any preemptive, subscription or other right of any person to acquire securities and constitutes in the aggregate all the issued and outstanding capital stock of all classes of the Company.

4.4 Authority Relative to This Agreement. The Company has the requisite corporate power and authority to enter into this Agreement and the agreements contemplated hereby to which it is to be a party (collectively, the "Company Transaction Documents") and to carry out its obligations hereunder and thereunder. The execution

and delivery of the Company Transaction Documents by the Company and the consummation by the Company of the transactions contemplated thereby have been duly and validly authorized and no other corporate proceedings on the part of the Company are necessary to approve the Company Transaction Documents or the transactions contemplated thereby. The Company Transaction Documents have been duly and validly executed and delivered by the Company and constitute valid and binding agreements of the Company, enforceable against the Company in accordance with their terms, except to the extent that enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and similar laws now or hereafter in effect relating to creditors' rights generally or by general principles of equity (regardless of whether enforceability is considered in a proceeding at law or in equity).

4.5 Consents and Approvals; No Violations. Except as disclosed on Schedule 4.5 hereto, no material filing with, and no material permit, authorization, consent or approval of, any public or governmental body or authority, and no material consent or waiver, of any third party, is necessary for the consummation by the Company, its Subsidiaries or the Selling Shareholders of the transactions contemplated by the Company Transaction Documents. Except as disclosed in Schedule 4.5 hereto, none of the execution and delivery of the Company Transaction Documents by the Company or the Selling Shareholders, the consummation by the Company or the Selling Shareholders of the transactions contemplated thereby, or compliance by the Company with any of the provisions thereof, will (a) conflict with or result in any breach of any provisions of the Articles of Incorporation or Bylaws of the Company or any Subsidiary, (b) subject to obtaining necessary third-party consents or other approvals set forth on Schedule 4.5 hereto, result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default under, result in the loss of any material benefit under or give rise to any right of termination, cancellation, acceleration or change in the award, grant, vesting or determination under, or result in the creation of any lien, charge, security interest or encumbrance upon any of the respective properties or assets of the Company or any of its Subsidiaries or the Selling Shareholders, under, any of the terms, conditions or provisions of any note, bond, mortgage, indenture, deed of trust, license, contract, lease, agreement, arrangement or other instrument or obligation, in each case that is material, to which the Company or any of its Subsidiaries or the Selling Shareholders is a party or by which the Company or the Selling Shareholders or any of the Company's or the Selling Shareholders' properties or assets may be bound or affected, or (c) violate any order, writ, injunction, decree, law, statute, rule or regulation, in each case that is material, of any court or federal, state, local or foreign body or authority, or any nongovernmental self-regulatory organization or agency to which the Company or any of its properties or assets may be subject.

4.6 Financial Statements. The Company has previously delivered to Delta (i) the audited consolidated financial statements of the Company and its Subsidiaries for the years 2001, 2002, and 2003 (including the footnotes thereto) (the "Audited Financial Statements"), and (ii) the audited consolidated financial statements of the Company and its Subsidiaries for the ten (10) months ended October 29, 2004 (including the consolidated balance sheet of the Company and its Subsidiaries for the ten (10) months ended October 29, 2004 and the related consolidated statements of income, shareholders'

equity and cash flows for the ten (10) months then ended (together, the “Interim Financial Statements”). All of such financial statements referred to in this Section 4.6 are collectively referred to herein as the “Company Financial Statements.” The Company Financial Statements (a) are complete; (b) have been prepared from, and are in accordance with, the books and records of the Company and (c) present fairly, in all material respects, the financial position and the results of operations of the Company and its Subsidiaries as of the dates and for the periods indicated, in each case in accordance with U.S. GAAP consistently applied throughout the periods involved except as otherwise stated therein, and subject, in the case of the Interim Financial Statements, to normal year end audit adjustments that are not, in the aggregate, material and to the absence of notes as may be required by U.S. GAAP. Such financial statements for the interim period reflects all reserves and adjustments necessary for a fair presentation of financial position and, to the extent presented, changes in financial position and results of operations for the period presented. The books and records of the Company and its Subsidiaries to which such statements relate are complete in all material respects and fully and fairly reflect bona fide transactions set forth therein.

4.7 No Material Adverse Change; Payables and Receivables. Except as disclosed on Schedule 4.7 hereto, or in the ordinary course of business, since October 29, 2004, (i) the business has been conducted by the Company and its Subsidiaries only in the ordinary course consistent with past practices and (ii) there has not been:

(A) any damage, destruction or loss to any tangible asset of the Company, whether or not covered by insurance, materially adversely affecting the business;

(B) any debts or obligations owing to the Company or its Subsidiaries that have been forgiven, reduced or cancelled, or any claims or rights other than in the ordinary course of business consistent with past practices;

(C) any claims, liabilities or obligations paid or satisfied (absolute, accrued, contingent or otherwise), other than the payment, discharge or satisfaction in the ordinary course of business and consistent with past practice of liabilities and obligations reflected or reserved against in the Interim Financial Statements or incurred in the ordinary course of business and consistent with past practice

(D) any material changes made in the credit practices of the Company or its Subsidiaries or in the methods or accounting principles used in maintaining its books, accounts or business records;

(E) any material adverse change in the business of the Company or any of its Subsidiaries, or any event or condition that has had or is likely to have a Material Adverse Effect;

(F) any transaction, commitment, contract or agreement entered into by the Company or any of its Subsidiaries or any relinquishment by the Company or any of its Subsidiaries of any contract or other right having a value of or involving aggregate payments in excess of one hundred thousand dollars (\$100,000);

(G) any declaration, setting aside or payment of any dividend or other distribution by the Company in respect of the Company's Capital Stock;

(H) a material change in the accounting principles as reflected in the Company Financial Statements;

(J) a material increase or reduction in the amount of the Company's reserves, except those made in accordance with U.S. GAAP;

(K) a redemption, purchase or other acquisition of any of the Company's or its Subsidiaries' capital stock;

(L) an increase in benefits or payments under, or the establishment of any bonus, insurance, severance, deferred compensation, pension, retirement, profit sharing, stock option (including, without limitation, the granting of stock options, stock appreciation rights, performance awards, or restricted stock awards), stock purchase or other employee benefit plan, Company Plan or Compensation Plan, or, except in the ordinary course of

business consistent with past practice, any other increase in the compensation payable or to become payable to any officers, key employees of, or independent contractors providing services to the Company or any of its Subsidiaries; or

(M) Liens (other than Permitted Liens) imposed on any of the Company's Assets. The term "Lien" as used in this Agreement means any mortgage, pledge, security interest, encumbrance, lien, claim or charge of any kind. The term "Permitted Lien" shall mean (a) Liens for current taxes and assessments not yet past due, (b) inchoate mechanics' and materialmen's Liens for construction in progress, (c) workmen's, repairmen's, warehousemen's and carriers' Liens arising in the ordinary course of business of the Company or any such Subsidiary of the Company, as applicable, consistent with their respective past practices and ordinary courses of business, (d) all matters of record, Liens and other imperfections of title and encumbrances that, individually or in the aggregate, would not impair the present use of the relevant Asset, and (e) zoning laws and other land use restrictions that do not impair the present use of the property subject thereto.

(b) As of the Closing Date, the Company's outstanding accounts payable do not exceed \$4,861,956 and the Company's outstanding receivables are not less than \$20,566,979, in each case using the same practices used in preparation of the Interim Financial Statements.

4.8 Absence of Undisclosed Liabilities. Except to the extent specifically disclosed on Schedule 4.8 hereto, neither the Company nor any of its Subsidiaries has liabilities or obligations of any nature (whether absolute, accrued, contingent or otherwise) required to be disclosed or reflected in the Company's financial statements that is not so disclosed or reflected except (a) liabilities or obligations that are accrued or reserved against in the most recent consolidated audited balance sheet of the Company contained in the Company Financial Statements, (b) liabilities or obligations that are accrued or reserved against in the Interim Financial Statements, and (c) liabilities or obligations arising since October 29, 2004, in the ordinary course of business and consistent with past practice.

4.9 Litigation. Except as set forth on Schedule 4.9 hereto, as of the date of this Agreement; (i) there is no action, suit, judicial or administrative proceeding, arbitration or investigation pending or, to the Knowledge of the Company threatened against or involving the Company or any of its Subsidiaries, or any of its or their properties or rights, before any court, arbitrator, or administrative or governmental body; (ii) there is no judgment, decree, injunction, rule or order of any court, governmental department, commission, agency, instrumentality or arbitrator outstanding against the Company or any of its Subsidiaries; and (iii) none of the Company or any of its Subsidiaries is in violation of any term of any judgment, decree, injunction or order outstanding against it. Neither the Company nor any Subsidiary has received written notice of any investigation threatened or contemplated by any foreign, federal, state or local governmental or regulatory authority, including those involving the safety of products, the working conditions of employees, or the Business' employment practices or policies. Neither the Company nor any Subsidiary has received any written demands

from an attorney or other legal representative of a claimant, which, individually or in the aggregate, would (if adversely determined) have a Material Adverse Effect upon the Company. Except as set forth on Schedule 4.9, no insurance company has asserted in writing that any action set forth on Schedule 4.9 is not covered by the applicable policy relating thereto.

4.10 Material Contracts; Certain Definitions. Schedule 4.10 sets forth an accurate and complete list of all written instruments, commitments, agreements, arrangements and understandings, to which the Company or a Subsidiary is a party or bound, or by which any of its assets are subject or bound, or pursuant to which the Company is a beneficiary, meeting any of the descriptions set forth below (the “Material Contracts”):

(a) Real Estate Leases, Personal Property Leases, Insurance, licenses of Intellectual Property or Customized Software (as defined in Section 4.31), Employment Contracts, Company Plans and Licenses and Permits;

(b) Any contract for capital expenditures or for the purchase of goods or services in excess of \$70,000;

(c) Any purchase order, agreement or commitment obligating the Company to sell or deliver any products with an aggregate value exceeding \$250,000;

(d) Any financing agreement or other agreement for borrowing money, any instrument evidencing indebtedness, any liability for borrowed money, any obligation for the deferred purchase price of property in excess of \$20,000 (excluding normal trade payables), or any instrument guaranteeing any indebtedness, obligation or liability;

(e) Any joint venture, partnership, cooperative arrangement or any other agreement involving a sharing of profits;

(f) Any advertising contract not terminable without payment or penalty on sixty (60) days (or less) notice;

(g) Any contract entered into outside the ordinary course of business;

(h) Any contract with any government or any agency or instrumentality thereof;

(i) Any contract with respect to the discharge, storage or removal of effluent, waste or pollutants;

(j) Any contract, license or royalty agreement related to the Company’s use of Company Intellectual Property;

(k) Any contract for the purchase or sale of any of its assets, other than in the ordinary course of business or granting an option with respect to the purchase or sale of any assets;

(l) Except for contracts, purchase orders, or other arrangements with customers, any contract to indemnify any party or to share in or contribute to the liability of any party, which indemnification or contribution obligation could reasonably be expected to result in liability to the Company in excess of \$10,000;

(m) Any contract for the purchase or sale of foreign currency or otherwise involving foreign exchange transactions;

(n) Any contract containing covenants not to compete in any line of business or with any person in any geographical area;

(o) Any contract relating to the purchase or sale of a portion of its requirements or output;

(p) Any other contract, commitment, agreement, arrangement or understanding related to the Business (other than those excluded by an express exception from the descriptions set forth in subsections (a) through (o) above) that (i) provides for payment or performance by either party thereto having an aggregate value of \$70,000 or more or (ii) is between an Affiliate (as defined in Section 4.24) of the Company and the Company;

(q) Any executory agreement (oral or written) with any customer guaranteeing a minimum profit margin, or agreeing to take back merchandise or to participate in price markdowns; and

(r) Any proposed arrangement of a type that if entered into would be a Material Contract.

The Company has heretofore furnished or made available to Delta and Purchaser complete and accurate copies of the confidentiality and non-competition agreements to which it is a party. The Company and each of its Subsidiaries has performed in all material respects all obligations required to be performed by it under any Material Contract, except for lack of performance that would not be a material breach of any such Material Contract. There has not been any event of default (or any event or condition which with notice or the lapse of time, both or otherwise, would constitute an event of default) under any Material Contract on the part of the Company or any of its Subsidiaries, or, to the Company's and its Subsidiaries' Knowledge, any other party thereof that would have a Material Adverse Effect. Each Material Contract is in full force and effect and is valid and enforceable by the Company or its Subsidiaries in accordance with its respective terms, except to the extent that enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and similar laws now or hereafter in effect relating to creditors' rights generally and by general principles of equity (regardless of whether enforceability is considered in a proceeding at law or in equity); and the performance of any Material Contract would not have a Material Adverse Effect. The Company has not received or given written notice of an intention to cancel or terminate a Material Contract or to exercise or not exercise options or rights under a Material Contract. The Company has not received any written notice of a

default, offset or counterclaim under any Material Contract, or any other communication calling upon the Company to comply with any provision of any Material Contract or ascertaining noncompliance.

Certain Definitions. For the purposes of this Agreement:

“Personal Property Leases” shall mean all leases or bailments of personal property used in the Business of the Company or its Subsidiaries requiring payments in excess of \$50,000 per year.

“Insurance” shall mean all binders, policies of insurance, self-insurance programs, or fidelity bonds.

“Licenses and Permits” shall mean collectively each material license, permit, certificate, approval, exemption, franchise, registration, variance, accreditation or authorization used in the Business.

#### 4.11 Employee Benefit Plans.

(a) Schedule 4.11(a) hereto contains a true and complete list of each bonus, deferred compensation, early retirement, incentive compensation, stock purchase, stock option, other equity-based compensation, severance pay, medical, life, insurance, welfare, vacation, disability, profit-sharing, thrift pension plan, program, agreement, scheme or arrangement, and each other employee benefit plan, program agreement or arrangement, sponsored, maintained or contributed to or required to be contributed to by the Company or any of its Subsidiaries or by any trade or business, whether or not incorporated, that together with the Company or any of its Subsidiaries would be deemed a “single employer” under Section 414 of the Code (an “ERISA Affiliate”) for the benefit of any employee, director or independent contractor or former employee, director or independent contractor of the Company or any of its Subsidiaries, whether formal or informal and whether legally binding or not, including (but not limited to) any such plan which is an “employee benefit plan” under Section 3(3) of ERISA (all of the foregoing, “Company Plans”). With respect to each Company Plan, Schedule 4.11(a) hereto identifies each ERISA Affiliate that sponsors, maintains, or contributes to the Company Plan and whether the Company Plan covers or provides benefits to current or former employees, directors or independent contractors of any ERISA Affiliate (and if so, the identity of each such ERISA Affiliate). Except as set forth on Schedule 4.11(a), neither the Company nor any of its Subsidiaries nor any ERISA Affiliate has any formal plan or commitment, whether legally binding or not, to create any additional plan which would qualify as a Company Plan or modify or change any existing Company Plan that would affect any current or former employee, director or independent contractor of the Company, any of its Subsidiaries or any ERISA Affiliate. For purposes of this Agreement, the term “Code” means the Internal Revenue Code of 1986 and the regulations promulgated thereunder, as amended from time to time, and the term “ERISA” means the Employee Retirement Income Security Act of 1974 and the regulations promulgated thereunder, as amended from time to time.



(b) With respect to each of the Company Plans, the Company has heretofore delivered or made available to Delta and Purchaser true and complete copies (as of the date hereof and to be updated through the time of Closing) of each of the following documents: (i) the Company Plan and related documents, including, without limitation, all amendments thereto, all related trust agreements, annuity or other insurance contracts or other documentation pertaining to the funding of such plan; (ii) the two most recent annual reports, actuarial reports, and financial statements, if any; (iii) the most recent Summary Plan Description, together with each Summary of Material Modifications, required with respect to such Company Plan, and all material employee communications relating to such Company Plan within the past thirty six (36) months; and (iv) the most recent determination letter received from the Internal Revenue Service (“IRS”) with respect to each Company Plan that is intended to be qualified under the Code and all material communications within the past thirty six (36) months to or from the IRS or any other governmental or regulatory authority relating to each Company Plan; and (v) the notices and election forms used to notify employees and their dependents of their continuation coverage rights under the Company’s group health plans (under Code Section 4980B(f) and ERISA Section 606), if applicable.

(c) Except as disclosed in Schedule 4.11(c), neither the Company nor any of its Subsidiaries, nor any ERISA Affiliate, nor any of the Company Plans, nor any trust created thereunder, nor, to the Knowledge of the Company, any non-employee trustee or administrator thereof has engaged in a transaction in connection with which the Company or any of its Subsidiaries, any of the Company Plans, any such trust of any trustee or administrator thereof, could, directly or indirectly, be subject to a material civil penalty assessed pursuant to Section 409 or 502(i) of ERISA, a material tax imposed pursuant to Section 4975, 4976, 4980B or 4980D of the Code or any other material liability.

(d) Full payment has been made, or will be made in accordance with Section 404(a)(6) of the Code and the requirements of the affected Company Plans, of all amounts that the Company or any of its Subsidiaries or any ERISA Affiliate is required to pay under the Code or under the terms of the Company Plans (including, without limitation, any employer contributions and salary reduction contributions), and all such amounts required to be paid or accrued will be paid on or prior to the Closing.

(e) None of the Company Plans is subject to Section 412 of the Code or Title IV of ERISA or is a “multiemployer pension plan,” as such term is defined in Section 3(37) of ERISA, a “multiple employer welfare arrangement,” as such term is defined in Section 3(40) of ERISA, or a single employer plan that has two or more contributing sponsors, at least two of whom are not under common control, within the meaning of Section 4063(a) of ERISA.

(f) Each of the Company Plans that is intended to be “qualified” within the meaning of Section 401(a) of the Code is so qualified and a favorable determination (opinion letter in the case of a standardized prototype plan) to that effect has been issued or requested and is expected to be issued by the IRS with respect to each such Company Plan. There has been no amendment to any Company Plan, and, to the Knowledge of the Company, no event has occurred, since the date of such determination that could

adversely affect the qualified status of any such Company Plan. Each of the Company Plans that is intended to satisfy the requirements of Section 125 or 501(c)(9) of the Code satisfies such requirements. Each of the Company Plans has been operated and administered in all material respects in accordance with its terms and applicable laws, including but not limited to ERISA and the Code.

(g) Except as set forth on Schedule 4.11(g) hereto, each Company Plan may be amended or terminated without liability to the Company or any of its Subsidiaries or any ERISA Affiliate.

(h) There are no claims pending, or, to the Knowledge of the Company, any of its Subsidiaries, or any ERISA Affiliate, threatened or anticipated (other than routine claims for benefits) against any Company Plan, the assets of any Company Plan or against the Company, any of its Subsidiaries, any ERISA Affiliate, or any fiduciary or administrator of a Company Plan with respect to any Company Plan. Other than qualified domestic relations orders and qualified child support orders, there is no judgment, decree, injunction, rule or order of any court, government body, commission, agency or arbitrator outstanding and unsatisfied against or in favor of any Company Plan or any fiduciary or administrator thereof with respect to a Company Plan (other than rules of general applicability). There are no pending or, to the Knowledge of the Company, threatened audits or investigations by any government body, commission or agency involving any Company Plan and, to the knowledge of the Company, no basis for any such claim exists.

(i) Except as disclosed on Schedule 4.11(i) hereto, no Company Plan provides benefits, including without limitation death or medical benefits (whether or not insured), with respect to current or former employees or directors of the Company or any of its Subsidiaries after retirement or other termination of service (other than (i) coverage mandated by applicable law, (ii) death benefit or retirement benefits under any “employee pension plan,” as that term is defined in Section 3(2) of ERISA, (iii) deferred compensation benefits accrued as liabilities on the books of the Company or any of its Subsidiaries or any ERISA Affiliate or (iv) benefits, the full cost of which is borne by the current or former employee or director (or his beneficiary)).

(j) Except as set forth on Schedule 4.11(j) hereto, neither the execution of this Agreement nor the consummation of the transactions contemplated hereby will result in, or is a precondition to, (i) any employee of the Company or any of its Subsidiaries becoming entitled to severance pay or any similar payment, (ii) the acceleration of the time of payment or vesting, or an increase in the amount of, any compensation due any employee of the Company or any of its Subsidiaries, (iii) the renewal or extension of the term of any agreement regarding the compensation of any employee of the Company or any of its Subsidiaries, or (iv) any amount payable under the Company Plans failing to be deductible for federal income tax purposes under Section 280G of the Code.

4.12 Taxes and Tax Payments.As used herein: “Tax Return” means any federal, state, local, foreign and other applicable return, declaration, report, claim for refund, information return or similar statement with respect to any Tax, including any

schedule or attachment thereto, and including any amendment thereof. “Tax” or “Taxes” means all taxes, charges, fees, levies, imposts, duties, and other assessments, including any income, alternative, minimum or add-on tax, gross income, gross receipts, sales, use, transfer, stamp duties, ad valorem, value-added, franchise, registration, title, license, capital, paid-up capital, profits, withholding, payroll, intangible, employment, excise, severance, occupation, premium, real property, personal property, federal highway use, commercial rent, transaction, environmental, or windfall profit tax, custom, duty or other tax, governmental fee or other like assessment or charge of any kind whatsoever, whether federal, state, local or foreign, together with any interest, penalties, or additions thereto, imposed by any governmental authority. Each of the Company and its Subsidiaries (i) has filed (or there has been filed on its behalf) all Tax Returns required to have been filed by each of them under applicable law, and all such Tax Returns are correct and complete in all material respects, and (ii) has paid all Taxes shown on such Tax Returns to be due and payable or a reserve for such Taxes has been set aside on the Company Financial Statements for all periods through and including the Closing Date, except for those Taxes contested in good faith for which adequate reserves have been properly established in accordance with U.S. GAAP. The Company has made available to Delta and Purchaser accurate and complete copies of all federal, state, and local income Tax Returns required to be filed by the Company or any of its Subsidiaries (or filed on their behalf), examination reports, and statements of deficiency assessed against or agreed to by the Company or any of its Subsidiaries since 2000.

(b) The Company and its Subsidiaries have withheld or collected and paid over to the appropriate governmental authorities (or are properly holding for such payment) all Taxes required by law to be withheld or collected.

(c) There are no material liens for Taxes (other than for Taxes not yet due and payable) on any assets of the Company.

(d) Except as set forth on Schedule 4.12 hereto, to the Knowledge of the Company there are no ongoing audits, examinations or other administrative or court proceedings of any Tax Returns of the Company or its Subsidiaries, and none of the Company, or any of its Subsidiaries, has been notified, formally or informally, by any taxing authority that any such audit, examination or proceeding is contemplated or pending.

(e) Except as set forth on Schedule 4.12 hereto, none of the Company or any of its Subsidiaries has executed or filed with the IRS or any other taxing authority any agreement or other document extending, or having the effect of extending, or waiving the period of assessment or collection of material Taxes for which the Company or any of its Subsidiaries could be liable.

(f) None of the Company or any of its Subsidiaries (A) has been a member of an affiliated group filing a consolidated federal income Tax Return or (B) has any liability for the Taxes of any person (other than the Company and its Subsidiaries) under Treasury Regulations Section 1.1502-6 (or any similar provision of state or local law), as a transferee or successor, by contract, or otherwise. None of the Company or any of its

Subsidiaries is a party to, is bound by, or has any obligation under, any tax sharing agreement.

(g) With respect to the Company or any of its Subsidiaries, there are no pending requests for rulings from any taxing authority with respect to any Taxes and there are no powers of attorney granted that are currently in force with respect to any matter related to Taxes that could affect the Company or any of its Subsidiaries.

(h) With respect to the Company or any of its Subsidiaries, to the Knowledge of the Company, there are no proposed reassessments by any taxing authority of any property owned or leased.

(i) To the Knowledge of the Company, no claim has been made by any authority in a jurisdiction where the Company or any of its Subsidiaries has not filed Tax Returns that they are subject to taxation by that jurisdiction.

(j) The Company is not and has at no time been a United States real property holding corporation (within the meaning of Section 897(c)(2) of the Code).

(k) The Company has been a validly electing S corporation (as defined in Code Section 1361(a)(1)) at all times during its existence and will remain an S corporation up to and including the Closing Date.

(l) Schedule 4.12 identifies any Subsidiary that is a “qualified subchapter S subsidiary” within the meaning of Section 1361(b)(3)(B) of the Code. Each Subsidiary so identified has been a qualified subchapter S subsidiary at all times from the date shown on Schedule 4.12 up to and including the Closing Date.

(m) The Company will not be liable for any Tax under Code Section 1374 in connection with any deemed sale of the Company's assets (including the assets of any qualified subchapter S subsidiary of the Company) caused by a Section 338(h)(10) Election.

4.13 Compliance with Laws. Except as set forth on Schedule 4.13, all activities of the Company have been, and are currently being, conducted in compliance with: (a) all applicable federal, state, local or foreign laws, ordinances, regulations, interpretations, judgments, decrees, injunctions, permits, licenses, certificates, governmental requirements, orders and other similar items of any court or other governmental entity (including, but not limited to, those of any nongovernmental self regulatory body), except for failure to comply which would not have individually or in the aggregate, a Material Adverse Effect; and (b) the terms and provisions of any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Company or any of its Subsidiaries is a party or by which the Company or any of its Subsidiaries or any property or asset of the Company or its Subsidiaries is bound or affected, except for failure to comply which would not have individually or in the aggregate, a Material Adverse Effect. The Company has not received written notice from any governmental body or other person alleging any violation of any laws.

4.14 Labor and Employment Matters.

(a) Contracts. Schedule 4.14(a) sets forth a correct and complete list of all material agreements, arrangements or understandings, written or oral, with officers, directors and employees of the Company or a Subsidiary, regarding services to be rendered, terms and conditions of employment, and compensation as of the date hereof, including, without limitation, any employee handbook(s) covering terms and conditions of employment for any employee of the Company or any Subsidiary (the “Employment Contracts”), but excluding the Company Plans identified on Schedule 4.11(a). A true and correct copy of each such written agreement, arrangement or understanding and an accurate description of each such oral agreement, arrangement or understanding has been provided or made available to the Purchaser. The Selling Shareholders do not have any employment or other compensation arrangements with, nor do they, as individuals, employ, any individuals who perform services for the Company or a Subsidiary. All Employees employed on terms other than pursuant to the Employment Contracts set forth on Schedule 4.14(a) are employed “at-will” by the Company or a Subsidiary.

(b) Compensation. Schedule 4.14(b) sets forth a correct and complete list of all employees of the Company or a Subsidiary as of the date hereof (“Employees”), and lists which Employees are part-time or temporary employees, the name, title, position or department, the present annual compensation, prior year’s bonus (if any), accruals for bonuses payable in respect of 2004, years of service, any interests in any incentive compensation plan (both contractual and discretionary), current vacation accrual for each Employee, and lists which Employees are currently on short-term or long-term disability and the entity that employs each such Employee. Schedule 4.14(b) sets forth an accurate and complete list of each employee who may become entitled to receive nonqualified, supplementary retirement benefits or allowances, whether pursuant to a contractual obligation or otherwise, and the estimated amounts of such payments. Since January 2, 2004, except in the ordinary course of business consistent with past practice or as disclosed on Schedule 4.14(b), the Company has not (i) approved, paid, or made any accrual or arrangement for the payment of, bonuses or special compensation of any kind, including, without limitation, any severance or termination pay, to any present or former officer or employee, (ii) made any general wage or salary increases or (iii) increased or altered any other benefits or insurance provided to any employee.

(c) There are no agreements or arrangements between the Company and any consultant, former consultant, Employee or former employee obligating the Company to make any payment, provide or accelerate any benefit, or increase compensation due to any such individual, as a result of the transactions contemplated by this Agreement, nor will the transactions contemplated by this Agreement result in any breach of any agreement with any consultant, former consultant, Employee or former employee.

(d) Except as disclosed on Schedule 4.14(d) hereto: (i) the Company, each of its Subsidiaries and to the Company’s Knowledge each of their respective subcontractors is, and has been in, material compliance with all applicable federal, state, local or foreign laws and any applicable customer code of conduct respecting employment and employment practices, terms and conditions of employment and wages and hours,

including, without limitation, such laws and codes of conduct respecting employment discrimination, equal opportunity, affirmative action, worker's compensation, occupational safety and health requirements, immigration and unemployment insurance and related matters, and are not engaged in and have not engaged in any unfair labor practice, except for such non-compliance that would not have a Material Adverse Effect; (ii) no investigation or review by or before any governmental entity or by any customer concerning any violations of any such applicable laws or applicable codes of conduct is pending or, to the Knowledge of the Company or its Subsidiaries, threatened, nor has any such investigation occurred during the last three (3) years and no governmental entity has provided any notice to the Company or any of its Subsidiaries asserting an intention to conduct any such investigations; (iii) there is no labor strike, dispute, slowdown or stoppage actually pending or, to the Knowledge of the Company and its Subsidiaries, threatened against the Company or any of its Subsidiaries; (iv) to the Knowledge of the Company and its Subsidiaries, no union representation question or union organizational activity exists respecting the employees of the Company or any of its Subsidiaries; and (v) none of the Company or any of its Subsidiaries has experienced any work stoppage or other labor difficulty during the last three (3) years.

(e) Other than as set forth in Schedule 4.14(e) hereto, no collective bargaining agreement exists that is binding on the Company or any of its Subsidiaries.

(f) Except as set forth on Schedule 4.14(f), the Company and its Subsidiaries have not incurred any liability during the last three (3) years under the federal Worker Adjustment Retraining Notification Act of 1988 or similar state and local laws and do not reasonably expect to incur any such liability as a result of actions taken or not taken prior to the Closing Date.

(g) Except as provided on Schedule 4.14(g), none of the employees of the Company or its Subsidiaries are "leased employees" within the meaning of Section 414(n) of the Code, and none of the employees of the Company or its Subsidiaries have, to the Knowledge of the Company, indicated a desire to terminate his or her employment in connection with the transactions contemplated by this Agreement. Each person who performs services for the Company or any of its Subsidiaries has been, and is, properly classified by the Company and its Subsidiaries as an employee or independent contractor.

4.15 Insurance Policies. Schedule 4.15 hereto sets forth a complete and accurate list of all policies of insurance maintained by each of the Company and its Subsidiaries with respect to any of its officers, directors, employees, shareholders, agents, properties, buildings, machinery, equipment, furniture, fixtures or operations, and a description of each claim in excess of forty five thousand dollars (\$45,000) made by each of the Company and its Subsidiaries during the two (2) -year period preceding the date hereof under any such policy of insurance. The Company has previously delivered to Delta and Purchaser or made available for Delta's inspection complete and accurate copies of all such policies of insurance and complete and accurate copies of all documentation regarding claims made thereunder. All such policies of insurance are in full force and effect, have been issued for the benefit of the Company or its Subsidiaries by properly licensed insurance carriers. The Company and its Subsidiaries have promptly and properly notified its insurance carriers of any and all claims known to it with respect to its operations or products for which it is insured. No notice of cancellation or non-renewal with respect to, or material increase of premium for, any Insurance has been received by the Company or its Subsidiaries.

4.16 Environmental Laws and Regulations. For the purpose of this Section 4.16, "Environmental Laws" shall mean and include the Comprehensive Environmental Response, Compensation and Liability Act; the Clean Air Act; the Clean Water Act; the Resource Conservation and Recovery Act; the Toxic Substances Control Act; the Safe Drinking Water Act; the Emergency Planning and Community Right-to-Know Act; the Oil Pollution Act; the Occupational Safety and Health Act; the Georgia Hazardous Site Response Act; the Georgia Hazardous Waste Management Act; and all other federal, state, local or foreign laws, codes, ordinances, acts or statutes relating to contamination or pollution of the air, surface water, groundwater, drinking water or land or to the protection of human health or the environment, together with any amendments, modifications or extensions thereof and any regulations, rules, orders or guidelines issued thereunder.

Except to the extent set forth on Schedule 4.16:

(a) To the Company's Knowledge, no hazardous or toxic substance, waste, pollutant or contaminant, petroleum product or other substance regulated under any Environmental Law ("Regulated Substance") has been released or disposed of by the Company, or to their Knowledge, their predecessors, on, in, under or about any of the Real Property, except in compliance with applicable Environmental Laws.

(b) To the Company's Knowledge, each of the Company and its Subsidiaries has at all times complied with and are in material compliance with all Environmental Laws.

(c) To the Company's Knowledge, each of the Company and its Subsidiaries has obtained, and maintains in full force and effect, all material permits and written governmental approvals required under Environmental Laws required in connection with the current operation of the Business ("Environmental Permits"). Each Environmental Permit is listed in Schedule 4.16(c) hereto. Each of the Company and its Subsidiaries is

in material compliance with all terms and conditions of all Environmental Permits in connection with the current operation of the Business.

(d) To the Company's Knowledge, neither the Company nor its Subsidiaries has received notice from any governmental agency or third party that the Company or Subsidiaries are required to undertake any investigation, cleanup, remediation, removal or abatement of a Regulated Substance at (1) any facility or property to which any regulated substance has been sent, directly or indirectly, for transportation, treatment, storage, disposal or recycling by the Company or its Subsidiaries, or (2) any property now or previously owned, managed, controlled, occupied, leased or otherwise used by the Company or its Subsidiaries.

(e) To the Company's Knowledge, neither the Company nor its Subsidiaries has paid or been assessed any civil, administrative or criminal fines, penalties, judgments or other amounts relating to alleged failure to comply with or liability under any Environmental Law or Environmental Permit, or has received any claim, written notice or had other communication from any third party for environmental damage to or response or cleanup costs for property.

(f) To the Company's Knowledge, neither the Company nor its Subsidiaries, has received any written notice regarding its or their alleged violation of, or liability or obligation under, any Environmental Law and have no knowledge of any order, ruling, writ, injunction or legal proceeding pursuant to any Environmental Law, or relating to the use, maintenance or operation of the Real Property that has been issued, is in progress or effect, or is threatened.

(g) To the Company's Knowledge, there are no underground storage tanks or above ground storage tanks located now or in the past on the Real Property.

(h) The Company has heretofore delivered to or made available to Delta and Purchaser complete and correct copies of all documents pertaining to the environmental condition of the Real Property in its possession, including without limitation, any environmental reports, filings, notifications, investigations, assessments, data, audits and site evaluations relating to any property controlled by the Company or its Subsidiaries; and all material correspondence and communications between the Company or its Subsidiaries and any third-party, or received from any third-party, relating to the environmental condition of the Real Property and any alleged or actual violation of, or claim or obligation under, any Environmental Law or Environmental Permit.

(i) The representations and warranties in this Section 4.16 shall be the sole and exclusive representations and warranties as environmental matters, including, without limitation, the Company's compliance with Environmental Law, and neither Delta nor Purchaser shall not rely on any other representations and warranties as to such matters.



4.17 Intellectual Property Rights. Schedule 4.17 hereto contains a complete and accurate list of all patents, registered trademarks, trade names, services marks, registered copyrights and applications for or registrations of any of the foregoing as to which the Company or any of its Subsidiaries is the owner or a licensee (except for off-the shelf computer software programs, which are not required to be listed), indicating the registered or other owner, registration number, and registration or other expiration date, if any, and whether such license is exclusive or nonexclusive. Except as disclosed on Schedule 4.17 hereto, the Company and each of its Subsidiaries is the sole and exclusive owner and owns, free and clear of any Lien, or has a license to use, all patents, trademarks, trade names, service marks, copyrights, applications for or registrations of any of the foregoing, processes, inventions, designs, technology, formulas, computer software programs, know-how and trade secrets used in or necessary for the conduct of its respective business as currently conducted (the “Company Intellectual Property”), except for any failure to own or failure to have a license that would not cause a Material Adverse Effect. Except as disclosed on Schedule 4.17 hereto, the Company has not received any claim, and, to the Knowledge of the Company and its Subsidiaries, no threat of a claim has been made, and, to the Knowledge of the Company and its Subsidiaries, no basis for any claim exists, with respect to the use of the Company Intellectual Property or challenging or questioning the validity or effectiveness of any license or agreement with respect thereto. Neither the use of the Company Intellectual Property by the Company or any of its Subsidiaries in the present conduct of its business nor any product or service of the Company or any of its Subsidiaries infringes on the intellectual property rights of any person. Except as disclosed on Schedule 4.17 hereto, no current or former shareholder, employee, officer, director or consultant of the Company has any rights in or to any of the Company Intellectual Property. All the Company Intellectual Property owned by the Company (“Company Owned Intellectual Property”) listed on Schedule 4.17 hereto has the status indicated therein and all applications are still pending in good standing and have not been abandoned. Except as disclosed on Schedule 4.17 hereto: (i) the Company Owned Intellectual Property is not the subject of any judicial or administrative proceeding; (ii) each of the Company and its Subsidiaries has made all statutorily required filings, if any, to record its interests, and taken reasonable actions to protect its rights, in the Company Owned Intellectual Property; (iii) to the Knowledge of the Company and its Subsidiaries, no person or entity nor such person’s or entity’s business or products has infringed, misused or misappropriated the Company Owned Intellectual Property or currently is infringing, misusing or misappropriating the Company Owned Intellectual Property; (iv) no other person or entity has any right to receive or any obligation to pay a royalty with respect to any of the Company Owned Intellectual Property or any product or service of the Company or any of its Subsidiaries; (v) none of the Company Owned Intellectual Property is subject to any extensions, renewals, Taxes or fees due before January 31, 2005; (vii) all rights of the Company in and to the Company Owned Intellectual Property are freely transferable without any consent, approval or payment which has not already been obtained or made by the Company, except for any consent, approval, or payment the failure of which to be obtained or made would not have a Material Adverse Effect; and (vii) to the Knowledge of the Company, the operation of the Business in the manner and geographic areas in which the business is currently

conducted by the Company does not interfere with or infringe upon any third-party patent right, trademark or copyright or any asserted rights of others, including without limitation, with respect to the current labels, logos, product designation, trade dress or packaging of any products.

#### 4.18 Real Property.

(a) Schedule 4.18(a) hereto sets forth a brief description of all real property (including the addresses thereof) that is either owned or physically located in Tift County, Georgia (“Owned Real Property”) or leased (“Leased Real Property”) by the Company and each of its Subsidiaries (the Owned Real Property and Leased Real Property, collectively, the “Real Property”). The Real Property constitutes all of the real property used by the Company relating to the Business. None of the Owned Real Property is in violation of any law or in violation of any building, zoning, or other ordinance, code or regulation, except for violations that would not have a Material Adverse Effect. With respect to the Owned Real Property, the Company or its Subsidiary, as applicable, owns good and marketable fee simple title to such Real Estate free and clear of any of the following: (i) leases, subleases, licenses, concessions or other agreements (written or oral) granting to any person the right to use or occupy such parcel or any portion thereof; (ii) outstanding options, rights of first offer, rights of first refusal or similar rights granted to third parties to purchase such parcel or any portion thereof or interest therein, and (iii) Liens other than Permitted Liens. There are no past due taxes or assessments relating to any of the Owned Real Property and the Company has not received any notice of any pending improvements or special lien or assessment affecting any of the Owned Real Property.

(b) No portion of any Owned Real Property has been condemned, requisitioned or otherwise taken by any public authority, and, to the Knowledge of the Selling Shareholders, no such condemnation, requisition or taking is threatened or contemplated. The Company will promptly notify Purchaser if any such Real Property becomes subject to any condemnation or if the Company learns that a condemnation is threatened or contemplated. The Company has all material licenses, certificates of occupancy, permits, certificates, approvals, and authorizations, including building and use permits, planning permissions and building regulations (collectively, the “Real Property Permits”), required to operate the Business as currently conducted and utilize the Real Property as such Real Property is currently being utilized. The Company has all easements and rights necessary to conduct the Business as currently conducted, including easements for all utilities, services, roadway, railway and other means of ingress and egress.

(c) The Company has delivered to the Purchaser correct and complete copies of property tax bills, property condition reports, title insurance policies, title reports, and existing surveys and similar reports with respect to each parcel of Owned Real Property. Except as set forth on Schedule 4.18(c), there are no brokerage, service, supply, utility, management or other agreements that in any manner affect the Owned Real Property.

(d) Each parcel of Owned Real Property and all improvements located thereon are zoned or have a variance or conditional use permit or valid planning permission for the current use by the zoning jurisdictions or planning authority in which it is located, and is in material compliance with all conditions and requirements of any building permit, use permits, conditional use permits or zoning classifications, subdivision approvals, zoning restrictions, building codes, environmental zoning and land-use laws and planning permissions, and other applicable national, regional, provincial, state or local laws and regulations (collectively, the “Requirements”) and complies in all respects with the requirements of all conditions, covenants and restrictions applicable thereto. The Company has not received written notice of any alleged violation of any of the Requirements or any of the conditions, covenants or restrictions affecting or relating to the Real Property and Company shall promptly deliver any such notice to Purchaser. There are no pending or, to the Knowledge of the Company or Selling Shareholders, threatened, actions or proceedings affecting or relating to the Owned Real Property including, without limitation, any action or proceeding regarding ownership of any of the Owned Real Property (including, without limitation, claims of adverse possession) or that might prohibit, restrict or impair the use and occupancy of any Owned Real Property, or result in the suspension, revocation, impairment, forfeiture or non-renewal of any of the Real Property Permits.

(e) Schedule 4.18(e) sets forth a correct and complete list of all Real Property leased or subleased by the Company or a Subsidiary (the “Real Estate Leases”). With respect to each Real Estate Lease, (i) each is in full force and effect and is binding and enforceable against the Landlord thereunder in accordance with its terms, except to the extent that enforcement thereof may be limited by bankruptcy, insolvency, reorganization, moratorium and similar laws now or hereafter in effect relating to creditors’ rights generally or by general principles of equity (regardless of whether enforceability is considered in a proceeding at law or in equity); (ii) all rental and other charges payable pursuant to the terms and conditions of the Lease have been paid and no rent has been paid in advance more than 30 days; (iii) there are no charges, offsets or defenses against the enforcement by any lessor of any agreement, covenant or condition on the part of the Company or a Subsidiary to be performed or observed pursuant to the terms of the Real Estate Leases; (iv) there are no material defaults by the Company or a Subsidiary of any agreement, covenant or condition on the part of the Company or a Subsidiary to be performed or observed pursuant to the terms of the Real Estate Leases; (v) there are no actions or proceedings pending or, to the Knowledge of the Company and Selling Shareholder, threatened, by the lessor under any Real Estate Lease; (vi) except for the security deposits identified on Schedule 4.18(e) hereto, no lessor holds any deposits for the Company’s accounts under any Real Estate Lease; (vii) the consummation of the sale of the Company Capital Stock will not constitute a prohibited transfer or assignment under any Real Estate Lease; and (viii) there are no defaults by any lessor of any agreement, covenant or condition on the part of such lessor to be performed or observed pursuant to the terms of any Real Estate Lease. The current expiration date and remaining options to extend the Real Estate Leases are as set forth on Schedule 4.18(e) hereto. Minimum monthly rent and additional rent under the Real Estate Leases are set forth on Schedule 4.18(e) hereto. Other than as set forth on Schedule 4.18(e) there are no

parties in possession of any portion of the Real Property subject to the Real Estate Leases, whether as lessees, tenants at will, trespassers or otherwise.

(f) Except as set forth on Schedule 4.18(f) attached hereto, the improvements located on the Owned Real Property and all of the major building systems located therein, including, but not limited to, the roof, structural walls, foundation, and heating and air conditioning systems and electrical and plumbing systems, are structurally sound and in good working order and condition, in good repair and free of defects in materials and workmanship, subject to ordinary wear and tear. Set forth on Schedule 4.18(f) attached hereto is a list of all capital improvements relating to the improvements located on the Owned Real Property which the Company intended to make or believes need to be made within the next twelve (12) months.

4.19 Personal Property. Except as set forth in Schedule 4.19 hereto, each of the Company and its Subsidiaries owns or leases, and upon consummation of the transactions contemplated by this Agreement, will own or lease, all tangible personal property required to conduct its business, in all material respects, in the ordinary and usual course of business and as conducted on the Closing Date. The machinery and equipment material to the business or operations of the Company and each of its Subsidiaries are in normal operating condition, ordinary wear and tear and obsolescence excepted, free from any known defects except such minor defects as do not substantially interfere with the continued use thereof in the conduct of normal operations.

4.20 Title as to Properties. Except as set forth on Schedule 4.20, each of the Company and its Subsidiaries has good and valid title free and clear of any Liens to all properties and assets reflected on the Audited Financial Statements or acquired after the dates thereof (except for properties and assets sold or otherwise disposed of in the ordinary course of business since the dates thereof), which includes each asset the absence or unavailability of which would have a Material Adverse Effect.

4.21 Permits, Licenses, etc. Except as set forth on Schedule 4.21, the Company and each of its Subsidiaries has all rights, permits, certificates, licenses, consents, franchises approvals, registrations, and other authorizations necessary to sell or market its products and services and otherwise carry on and conduct its businesses and own, lease, use and operate its properties and assets at the places and in the manner now conducted and operated, except for rights, permits, certificates, licenses, consents, franchises approvals, registrations, and other authorizations the failure to have would not cause a Material Adverse Effect. All such rights, permits, certificates, licenses, consents, franchises approvals, registrations, and other authorizations are valid and in full force and effect. None of the Company or any of its Subsidiaries has received any written notice or claim pertaining to the failure to obtain any permit, certificate, license, franchise, approval, registration or other authorization required by any federal, state, local or foreign body or authority, and the Company has no Knowledge of any such failure with respect to any material permit, certificate, license, franchise, approval, registration or other authorization required by any federal, state, local or foreign body or authority.

#### 4.22 Product Liability Claims; Product Warranty.

(a) Except as disclosed on Schedule 4.22(a) hereto, during the last six (6) years, none of the Company or any of its Subsidiaries has received a claim, or incurred any uninsured or insured liability, for or based upon breach of product warranty (other than warranty service and repair claims in the ordinary course of business), strict liability in tort, negligent manufacture of product, negligent provision of services or any other allegation of liability, including or resulting in, but not limited to, product recalls, arising from the materials, design, testing, manufacture, packaging, labeling (including instructions for use) or sale of its products or from the provision of services (hereafter collectively referred to as "Product Liability"). To the Company's Knowledge, no circumstances exist involving the safety aspects of the Business' products that would cause any obligation to report to any federal, state or local agency.

(b) All products manufactured, marketed, distributed, shipped or sold by the Company or a Subsidiary within the last three (3) years have been in material conformity with all applicable contractual commitments and all expressed warranties. No liability exists for repair, replacement or damage in connection with such sales or deliveries, in excess of the reserve therefor on the Financial Statements. All warranties of the Business are in material conformity with the labeling and other requirements of the Magnuson-Moss Warranty Act and other applicable laws. The aggregate annual dollar value of product warranty and return experience for the year ended January 2, 2004, and the interim period through the date hereof is set forth in Schedule 4.22(b).

4.23 Officers, Directors and Employees. Prior to the date hereof, the Company has provided to Delta and Purchaser a list that completely and accurately sets forth the name and current annual salary rate of each officer, director or employee of each of the Company and its Subsidiaries whose total remuneration for the last fiscal year was in excess of fifty thousand dollars (\$50,000), together with a summary of the bonuses, commissions, additional compensation and other like benefits, if any, paid or payable to such persons for the last fiscal year, and in effect or proposed for the current year.

4.24 Transactions with Affiliates. Except as set forth on Schedule 4.24, none of the Company's shareholders, directors, officers or employees or any of their respective Affiliates is involved in any business arrangement or relationship with the Company or any of its Subsidiaries (whether written or oral), and none of the Company's shareholders, directors, officers or employees or any of their respective Affiliates owns any property or right, tangible or intangible, which is necessary to the business of the Company or any of its Subsidiaries. Each contract, agreement, license, lease, arrangement, and commitment listed in Schedule 4.24 was entered into by the Company in the ordinary course of business upon terms that are fair and reasonable to the Company without regard to the status and relationship of such parties. For purposes of this Agreement, "Affiliate" means (i) with respect to any corporate person or entity, any other person or entity that, directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such person or entity, and the term "control" (including the terms "controlled by" and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the

management policies of such person or entity, whether through ownership of voting securities, by contract or otherwise, and (ii) with respect to any individual, any relative or partner of such individual.

4.25 Absence of Certain Commercial Practices. Neither the Company, nor any officer, agent or employee of the Company, nor, to the Knowledge of Selling Shareholders, any other person acting on behalf of the Company (a) has made any unlawful domestic or foreign political contributions, (b) has made any payment or provided services which were not legal to make or provide or which the Company or any officer, employee or other person should have known were not legal for the payee or the recipient of the services to receive, (c) has received any payments, services or gratuities which were not legal to receive or which the Company or such person should have known were not legal for the payor or the provider to make or provide, (d) has had any transactions or payments which are not recorded in its accounting books and records or disclosed in its financial statements, (e) has had any off-book bank or cash accounts, (f) has made any payments to governmental officials in their individual capacities for the purpose of affecting their action or the action of the government they represent to obtain special concessions, or (g) has made illegal payments to obtain or retain business.

4.26 Inventories and Receivables.

(a) The inventory of the Company and each of its Subsidiaries as of October 29, 2004 is reflected in the Company Financial Statements as of such date in accordance with U.S. GAAP (subject to the reserves provided for therein). Except as disclosed in Schedule 4.26(a) hereto: (i) since October 29, 2004, the Company and each of its Subsidiaries has acquired and disposed of inventory only in the ordinary course of business; (ii) subject to the reserves provided for therein, the booked inventory of the Company and its Subsidiaries consists of items of a quality salable or usable in the ordinary course of business (except to the extent returnable to the vendors thereof for the full Purchase Price); (iii) none of the Company or any of its Subsidiaries is bound by any inventory purchase commitment, whether oral or written, formal or informal, that is not cancelable by such person without penalty on written notice of sixty (60) days or less, or which was not ordered in connection with a valid purchase order, letter of intent, instruction, forecast or manufacturing agreement from a customer; (iv) subject to normal reserves in accordance with past practice not exceeding the amounts of such reserves in the Company Financial Statements, the accounts receivable of the Company and its Subsidiaries are, and as of the Closing will be, valid and are subject to no counterclaim, set-off or other deduction or notice of refusal to pay (other than those arising from standard procedures and contractual provisions relating to the retest, repair and replacement of customer returns); and (v) all receivables arose in the ordinary course of business in arms-length transactions for goods actually sold and services actually performed or to be performed and no receivables are subject to prior assignment, claim, lien or security interest.

(b) Schedule 4.26(b) hereto sets forth a complete list of the addresses of all warehouses and other facilities in which the inventories of the Company and its Subsidiaries are located.

#### 4.27 Relations with Customers and Suppliers.

(a) Schedule 4.27(a) sets forth the names and addresses of all of the customers and suppliers of the Company and its Subsidiaries that ordered or provided goods or merchandise, raw materials, supplies, merchandise and other goods, as the case may be, from or for the Company or its Subsidiaries, with an aggregate value or purchase price, as the case may be, of one hundred thousand dollars (\$100,000) or more during the period from January 1, 2003 to October 29, 2004.

(b) Except as disclosed in Schedule 4.27(b) hereto, to the Knowledge of the Company and its Subsidiaries: (i) neither the public announcement nor consummation of the transactions contemplated hereby will cause any such customer or supplier listed on Schedule 4.27(a) to terminate its business relationship with the Company or any of its Subsidiaries; (ii) since December 31, 2003 none of the Company or its Subsidiaries has received written notice from any of such customers of a demand for renegotiation of the margin or mark-up or price re-determination of any material business transaction that has not been resolved; (iii) no written notice has been received, and there is no reason to believe, that any such customer has ceased or will cease after the Closing Date to use the goods or merchandise currently provided by the Company or any of its Subsidiaries, or has substantially reduced or will substantially reduce after the Closing Date the use of such goods or merchandise at any time; and (iv) no written notice has been received, and there is no reason to believe, that any such supplier will not sell raw materials, supplies, merchandise or other goods to the Company or any of its Subsidiaries at any time after the Closing Date on terms and conditions substantially similar to those used in its current sales to the Company and its Subsidiaries, subject only to general and customary price increases.

(c) Schedule 4.27(c) hereto fairly and accurately sets forth in all material respects the Company's and each of its Subsidiaries' customer sales deductions or notices of requests for such deductions (with corresponding amounts and explanations why such dilutions have occurred) for the 9-month period ending September 30, 2004, other than dilutions for any customer that have not, individually or in the aggregate, exceeded fifty thousand dollars (\$50,000) for such customer in such period (each such customer, a "Principal Customer").

(d) Since January 1, 2004, the Company has not suffered any material quality assurance failures as determined by any customer of the Company or any laboratory designated by any customer of the Company.

#### 4.28 Sales and Purchase Orders Backlog.

(a) Schedule 4.28(a) hereto lists all sales orders and aggregate orders with respect to any style exceeding one hundred thousand dollars (\$100,000) per order, which have been accepted by the Company or its Subsidiaries, and which were open as of November 26, 2004.

(b) Schedule 4.28(b) hereto lists all purchase orders exceeding one hundred thousand dollars (\$100,000) per order, which have been issued by the Company or its Subsidiaries, and which were open as of November 26, 2004.

4.29 Customs Issues. Except as set forth on Schedule 4.29 hereto (which disclosure, subject to Section 7.13 shall not reduce any claim for indemnification for Damages hereunder to the extent that the cost of settlement with the CCRA exceeds \$\*\*\*\*\*), the Company and each of its Subsidiaries are and for the past five years have been, in material compliance with all laws and regulations administered by the United States Bureau of Customs and Border Protection (“Customs”) and the CCRA, including but not limited to all requirements relating to preferential tariff programs, quantitative restrictions (i.e., quotas), country-of-origin marking, valuation, and tariff classification under the Harmonized Tariff Schedule of the United States (19 U.S.C. § 1202), as amended (the “HTSUS”) and any similar Canadian law or regulation. Without limiting the generality of the foregoing, the Company and each of its Subsidiaries have timely submitted to the Office of the Commissioner of Customs of the United States all cost submissions necessary to receive duty concessions allowable under the HTSUS and any similar Canadian law or regulation. The Company and each of its Subsidiaries hereby warrant that, to the best of their Knowledge, they are not currently under investigation for any violations of the laws and regulations administered by Customs or the CCRA generally and 19 U.S.C. § 1592 in particular, and further warrant that they are not the subject of a pending criminal, civil penalty, or liquidated damages proceeding alleging violations of these laws or regulations.

4.30 Books, Records and Bank Accounts.

(a) The minute books of the Company and each of its Subsidiaries, as previously made available to Delta and Purchaser and its representatives, contain complete and accurate records of all meetings of and corporate actions or written consents by the shareholders, Board of Directors, and committees of the Board of Directors of the Company and its Subsidiaries from January 1, 1990 through the date of such minutes.

(b) The minute books and stock ledgers of each of the Company and each of its Subsidiaries that have been made available to Delta and Purchaser constitute all of the minute books and stock ledgers of such companies from July 1994 through the Closing Date.

(c) Each of the Company and its Subsidiaries makes and keeps financial books, records and accounts which, in reasonable detail and in all material respects, are complete and fairly reflect its transactions and dispositions of its assets and securities and maintains a system of internal accounting controls sufficient to provide assurances that: (i) transactions involving any of the Company or its Subsidiaries are executed in accordance with management’s general or specific authorizations; (ii) transactions are recorded as necessary (A) to permit the preparation of financial statements for the Company and its Subsidiaries in conformity with U.S. GAAP or any other criteria applicable to such statements, and (B) to maintain accountability for assets; (iii) access to



the assets of the Company and its Subsidiaries is permitted only in accordance with management's general or specific authorizations; and (iv) the recorded accountability for assets is compared with existing complete and accurate assets at reasonable intervals and appropriate action is taken with respect to any differences. A complete and accurate list of all bank accounts of the Company and the signatories thereto, is set forth on Schedule 4.30.

4.31 Software and Information Systems. Except as set forth in Schedule 4.31 (the "Customized Software"), all computer software programs used in the Business are standard, off-the-shelf programs. The Company or a Subsidiary owns or holds, royalty free, non-exclusive licenses to use the Customized Software in connection with the Business. Except as set forth in Schedule 4.31, the Customized Software is not subject to any transfer, assignment, source code escrow agreement, reversion, site, equipment, or other operational limitations. Copies of all licenses and other agreements with respect to Customized Software have been made available to Purchaser.

4.32 Brokers. Except as set forth on Schedule 4.32, none of the Selling Shareholders, the Company or any of its Subsidiaries is obligated to pay any financial advisor, broker or investment banker in connection with the transactions contemplated by this Agreement.

4.33 No Material Misrepresentations or Omissions. To the Knowledge of the Company, all information provided or to be provided in writing by or on behalf of the Company, is or will be materially true and correct as of the date set forth in such written information and does not and will not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements made therein, and in light of the circumstances under which they were made, is not misleading as of the date set forth in such written information.

## ARTICLE V

### **CERTAIN REPRESENTATIONS, WARRANTIES AND COVENANTS OF THE SELLING SHAREHOLDERS**

The Selling Shareholders severally represent and warrant to Delta and the Purchaser, as of the date hereof, as follows:

5.1 Organization; Authority Relative to This Agreement; No Violations. The execution and delivery by the Selling Shareholders of this Agreement, the Employment Agreement, and the Investor Representation Letter (the "Selling Shareholders' Transaction Documents") and the consummation by the Selling Shareholders of the transactions contemplated thereby have been duly and validly authorized by all necessary action, and each Selling Shareholder has the necessary capacity to enter into the Selling Shareholders' Transaction Documents.

5.2 Shares of the Company. The Company Capital Stock that the Selling Shareholders are selling to Purchaser is free and clear of all liens, charges, encumbrances and preemptive rights, and represent all of the Company's issued and outstanding shares. No party, other than the Selling Shareholders, has any interest in the Company Capital Stock. Upon delivery to the Purchaser at the Closing of certificates representing the Company Capital Stock, good and valid title to the Company Capital Stock will pass to the Purchaser, free and clear of any Lien. Each Selling Shareholder has good and marketable title to all of the shares of Company Capital Stock to be sold by such Selling Shareholder hereunder and the absolute right to sell, assign, transfer and deliver the Company Capital Stock registered in such Selling Shareholder's name to the Purchaser, free and clear of all claims, security interests, liens, pledges, charges, escrows, options, proxies, rights of first refusal, preemptive rights, hypothecations, prior assignments, title retention agreements, security agreements or any other limitation, encumbrance or restriction of any kind.

5.3 Brokers. The Selling Shareholders are not obligated to pay any financial advisor, broker, or investment banker in connection with the transactions contemplated by this Agreement.

5.4 Litigation. Except as set forth on Schedule 5.4 hereto, as of the date of this Agreement; (i) there is no action, suit, judicial or administrative proceeding, arbitration or investigation pending or, to the Knowledge of the Selling Shareholders threatened against or involving any of the Selling Shareholders relating to the Company Capital Stock; (ii) there is no judgment, decree, injunction, rule or order of any court, governmental department, commission, agency, instrumentality or arbitrator outstanding against any of the Selling Shareholders relating to the Company Capital Stock; and (iii) none of the Selling Shareholders is in violation of any term of any judgment, decree, injunction or order outstanding against him or her relating to the Company Capital Stock. None of the Selling Shareholders has received any written demands from

an attorney or other legal representative of a claimant, which, individually or in the aggregate, would (if adversely determined) have a material adverse effect upon the Company Capital Stock to be sold to Purchaser.

5.5 No Material Misrepresentations or Omissions. To the Knowledge of the Selling Shareholders, all information provided or to be provided in writing by or on behalf of the Selling Shareholders, is or will be materially true and correct as of the date set forth in such written information and does not and will not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements made therein, and in light of the circumstances under which they were made, is not misleading as of the date set forth in such written information.

## ARTICLE VI

### CONDUCT OF BUSINESS PENDING THE CLOSING

6.1 Conduct of Business by the Company. During the period from the date of this Agreement and continuing until the Closing, without the consent of Delta and Purchaser:

(a) The business of the Company and each of its Subsidiaries shall be conducted only in the ordinary and usual course of business and consistent with past practices;

(b) None of the Company or any of its Subsidiaries shall: (i) amend its Articles of Incorporation or Bylaws; or (ii) split, combine or reclassify any shares of its outstanding capital stock or declare, set aside or pay any dividend or other distribution payable in cash, stock or property in respect of its capital stock, or directly or indirectly redeem, purchase or otherwise acquire any shares of its capital stock; provided however, that, notwithstanding this clause (ii) or anything else in this Agreement, the Company shall have the right to (A) pay monthly dividends of profits to the Selling Shareholders consistent with past practice up to an aggregate of \$192,000 per month, (B) make distributions to cover Tax liabilities of Selling Shareholders with respect to the Company in respect of taxable years ending on or before the Closing, which tax distributions shall not exceed an aggregate of 42% of the actual taxable income of the Company for each such taxable year, provided, that, immediately prior to Closing, the Company shall provide Delta a schedule showing all such distributions made under the foregoing clauses (A) and (B), and (C) distribute to the Selling Shareholders certain agreed upon items of personal property, including without limitation, automobiles, personal effects and the like, with the prior written approval of Delta, which shall not be unreasonably withheld. None of the distributions set forth in the foregoing clauses (A), (B), and (C) shall have any effect on the Purchase Price;

(c) None of the Company or any of its Subsidiaries shall: (i) acquire, dispose of, transfer, lease, license, mortgage, pledge or encumber any material fixed or

other assets, enter into any material contract or make any material capital expenditure, other than in the ordinary course of business and consistent with past practices; (ii) incur, assume or prepay any material indebtedness, liability or obligation or any other material liabilities or issue any debt securities; (iii) assume, guarantee, endorse or otherwise become liable or responsible (whether directly, contingently or otherwise) for the obligations of any other person in a material amount; (iv) make any material loans, advances or capital contributions to, or investments in, any other person; (v) fail to maintain adequate insurance consistent with past practices for its businesses and properties; (vi) commence any litigation; or (vii) enter into any contract, agreement, commitment or arrangement with respect to any of the foregoing;

(d) The Company and each of its Subsidiaries shall use its commercially reasonable efforts to preserve intact the business organization of the Company and its Subsidiaries, to keep available the services of its present officers and key employees, and to preserve the goodwill of those having business relationships with it, in accordance with past practices; and

(e) The Company will promptly notify Purchaser if any Real Property becomes subject to any condemnation or if the Company learns that a condemnation is threatened or contemplated.

6.2 Compensation Plans. During the period from the date of this Agreement and continuing until the Closing, each of the Company and its Subsidiaries shall not, without the prior written consent of Delta, which shall not be unreasonably withheld, (except as required by applicable law or pursuant to existing contractual arrangements or solely to the extent necessary to make compensation increases in the ordinary course of business consistent with past practices or make available existing benefit arrangements to new or promoted employees in the ordinary course of business in accordance with past practices): (a) enter into, adopt or amend any employment or severance agreement or arrangement or any plan which would qualify as a Company Plan, for the benefit of one or more of its officers, directors, employees, or independent contractors of the Company or any of its Subsidiaries, as applicable, in each case so as to increase materially benefits thereunder (collectively, the "Compensation Plans"); (b) grant or become obligated to grant any increase in the compensation or fringe benefits of any of its directors, officers, employees or independent contractors (including any such increase pursuant to any amendment to a Compensation Plan) except, with respect to employees other than officers, for increases in compensation in the ordinary course of business consistent with past practice, or enter into any contract, commitment or arrangement to do any of the foregoing; or (c) enter into or renew any contract, agreement, commitment or arrangement providing for the payment to any director, officer, employee, or independent contractor of compensation or benefits contingent, or the terms of which are materially altered in favor of such individual, upon the occurrence of any of the transactions contemplated by this Agreement.

6.3 Advice of Changes; Governmental Filings. Between the date hereof and the Closing Date, Delta and the Company shall confer on a regular basis with the other, report on operational matters and shall promptly advise the other party both orally and in writing of any change or event having, or which, insofar as can reasonably be foreseen, could have, a Material Adverse Effect on that party or that would cause or constitute a material breach of any of the representations, warranties or covenants of that party contained in this Agreement. Except where prohibited by applicable statutes and regulations, each party shall promptly provide the other (or its counsel) with copies of all other filings made by such party with any state or federal government entity in connection with this Agreement or the transactions contemplated hereby.

6.4 Risk of Loss. In the event that any material asset of the Company or any of its Subsidiaries is materially damaged or destroyed prior to the Closing Date (any such event being herein referred to as an “Event of Loss”), the Company (or its Subsidiary, as the case may be), at its expense, shall use its commercially reasonable efforts to replace or repair the property with comparable property of like value and quality as soon as possible before the Closing Date. If any Event of Loss shall have a Material Adverse Effect and repair or replacement cannot be accomplished by the Closing Date, Delta and Purchaser may elect, as their sole remedy:

(a) To postpone the Closing Date, until such time as such property has been restored to substantially its condition immediately prior to the Event of Loss, but in no event later than 30 days after the date referred in Section 9.1(b)(i);

(b) To close the transaction on the Closing Date, and accept the property as is, together with all of the Company’s and its Subsidiaries’ rights under any insurance policies and all insurance proceeds, covering that Event of Loss including property damage, loss of income and continuing expenses; or

(c) To terminate this Agreement without liability to either party by written notice to the Company within thirty (30) days after the Event of Loss has occurred.

## **ARTICLE VII**

### **ADDITIONAL AGREEMENTS**

#### 7.1 Access and Information.

(a) The Company shall afford Delta and Purchaser and their financial advisors, legal counsel, accountants, consultants and other representatives upon reasonable notice, access during normal business hours throughout the period from the date hereof to the Closing Date to all of its and its Subsidiaries’ books, records, properties, facilities, personnel commitments and records and, during such period, the Company and its Subsidiaries shall furnish promptly to, Delta and Purchaser, all information concerning its business, properties and personnel as reasonably requested; provided, that Delta, Purchaser, and their representatives shall coordinate such access through the Chief Financial Officer of the Company.

(b) All information furnished by the Company and each of its Subsidiaries to Delta and Purchaser pursuant hereto shall be treated as the sole property of the Company, subject to the terms of the Confidential Disclosure Agreement dated as of September 10, 2004 between Delta and the Company.

7.2 Management of the Company. For so long as any portion of the Performance Payment remains payable:

(a) \*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*and

(b) the Company, Delta, and Purchaser shall afford the Selling Shareholders, and their respective financial advisors, legal counsel, accountants, consultants and other representatives upon reasonable notice, access during normal business hours to all of the Company's books and records for the purpose of verification of Net Sales and EBIT.

7.3 No Solicitation of Transactions.

From the date hereof until the earlier of termination of this Agreement or the Closing, none of the Company or any of its Subsidiaries will, directly or indirectly, whether through any director, officer, employee, financial advisor, legal counsel, accountant, other agent or representative (as used in this Section 7.3, "Representatives") or otherwise, (A) initiate, solicit or encourage, or take any other action to facilitate any inquiries or the making of any proposal with respect to, or (B) except to the extent required in the exercise of the fiduciary duties of the Board of Directors of the Company or any of its Subsidiaries, under applicable law as advised by independent counsel in connection with an unsolicited proposal, engage or participate in negotiations concerning, provide any nonpublic information or data to, or have any discussions with, any person other than a party hereto or their representatives relating to, any (i) acquisition, (ii) tender offer (including a self-tender offer), (iii) exchange offer, (iv) merger, (v) consolidation, (vi) acquisition of beneficial ownership of (or the right to vote securities representing) 10% or more of the total voting power of such entity or any of its Subsidiaries, (vii) dissolution, (viii) business combination, (ix) purchase of all or any significant portion of the assets or any division of (or any equity interest in) such entity, or (x) any similar transaction other than the stock purchase contemplated by this Agreement (such proposals, announcements, or transactions being referred to as "Acquisition Proposals"). Notwithstanding the foregoing, this Section 7.3 shall not prohibit the Board of Directors of the Company from (i) furnishing information to or entering into discussions or negotiations with, any person or entity that makes an unsolicited bona fide Acquisition Proposal, if, and only to the extent that, (a) the Board of Directors of the Company determines in good faith that such action is so required for the Board of Directors to comply with its fiduciary duties to shareholders imposed by law and the Board has been so advised in writing (with a copy furnished to Delta) by independent, outside counsel, in its judgment and opinion, as being so required, (b) prior to furnishing information to, or entering into discussions and negotiations with, such person or entity, the Company

provides written notice to Delta to the effect that it is furnishing information to, or entering into discussions or negotiations with, such person or entity, and (c) the Company keeps Delta informed of the status and all material information with respect to any such discussions or negotiations. Nothing in this Section 7.3 shall (x) permit the Company to terminate this Agreement (except as specifically provided in Article IX hereof), (y) permit the Company or any of its Subsidiaries to enter into any Agreement with respect to an Acquisition Proposal for as long as this Agreement remains in effect (it being agreed that for as long as this Agreement remains in effect, none of the Company or any of its Subsidiaries shall enter into any Agreement with any person that provides for, or in any way facilitates, an Acquisition Proposal), or (z) affect any other obligation of the Company under this Agreement.

#### 7.4 Efforts to Close.

(a) Subject to the conditions herein provided, each of the parties hereto agrees to use its reasonable best efforts to take, or cause to be taken, all action and to do, or cause to be done, all things necessary, proper or advisable to consummate and make effective as promptly as practicable the transactions contemplated by this Agreement and to cause the conditions to Closing set forth in Article VIII hereof to occur, including, without limitation, cooperating with each other, using reasonable best efforts to obtain all necessary waivers, consents and approvals and effecting all necessary registrations and filings, including, without limitation: (i) obtaining the consents set forth on Schedule 4.5 hereto; (ii) Delta or Purchaser submitting a report and notice to the Israeli Corporate and Securities Authorities and the shareholders of Delta if and as required under Israeli corporate and securities laws; and (iii) submitting information requested by governmental authorities. In furtherance and not in limitation of the foregoing, each party hereto agrees to supply as promptly as practicable any additional information and documentary material that may be requested by a governmental authority pursuant to the H-S-R Act and use its reasonable best efforts to take, or cause to be taken, all other actions consistent with this Section 7.4 necessary to cause the expiration or termination of the applicable waiting periods under the H-S-R Act as soon as practicable; provided that the failure to cause a condition to Closing to occur shall not be a breach of this Agreement unless the failure results from a party's failure to use its reasonable best efforts to cause such condition to occur.

(b) Each of the Company and Delta shall, in connection with the efforts referenced in Section 7.4(a) hereof to obtain all requisite approvals and authorizations for the transactions contemplated by this Agreement under the H-S-R Act or any other Antitrust Law, use its reasonable best efforts to: (i) cooperate in all respects with each other in connection with any filing or submission and in connection with any investigation or other inquiry, including any proceeding initiated by a private party; and (ii) keep the other party informed in all material respects of any material communication received by such party from or given by such party to, the Federal Trade Commission (the "FTC"), the Antitrust Division of the Department of Justice (the "DOJ") or any other governmental entity, and of any material communication received or given in connection with any proceeding by a private party, in each case regarding any of the transactions contemplated hereby; and (iii) permit the other party to review any material

communication given by it to, and consult with each other in advance of any meeting or conference with, the FTC, the DOJ or any such other governmental entity or, in connection with any proceeding by a private party, with any other person, and to the extent permitted by the FTC, the DOJ or such other applicable governmental entity or other person, give the other party the opportunity to attend and participate in such meetings and conferences. For purposes of this Agreement, “Antitrust Law” means the Sherman Act, as amended, the Clayton Act, as amended, H-S-R Act, and the Federal Trade Commission Act, as amended. Notwithstanding the foregoing covenants concerning the reasonable best efforts of the parties contained in Section 7.4(a) and Section 7.4(b) hereof, each of the parties hereto shall use its commercial best efforts to resolve such objections if any, as may be asserted by a governmental entity or other person with respect to the transactions contemplated hereby under any Antitrust Law. In connection with the foregoing, if any administrative or judicial action or proceeding, including any proceeding by a private party, is instituted (or threatened to be instituted) challenging any transaction contemplated by this Agreement as violative of any Antitrust Law, each of the parties hereto shall cooperate in all respects with each other and use its respective commercial best efforts to contest and resist any such action or proceeding and to have vacated, lifted, reversed or overturned any decree, judgment, injunction or other order, whether temporary, preliminary or permanent, that is in effect and that prohibits, prevents or restricts consummation of the transactions contemplated by this Agreement. Notwithstanding the foregoing or any other provision of this Agreement, nothing in this Section 7.4 shall: (i) limit a party’s right to terminate this Agreement pursuant to Section 9.1(b)(i) hereof so long as such party has up to then complied in all material respects with its obligations under this Section 7.4; or (ii) require Delta or Purchaser to (x) enter into any “hold-separate” agreement or other agreement with respect to the disposition of any assets or businesses of Delta or any of its Subsidiaries or the Company or any of its Subsidiaries in order to obtain clearance from the FTC or the DOJ or any state antitrust or competition authorities to proceed with the consummation of the transactions contemplated hereby, (y) consummate the transactions contemplated hereby in the event that any consent, approval or authorization of any governmental entity obtained or sought to be obtained in connection with this Agreement is conditioned upon the imposition of any other significant restrictions upon, or the making of any material accommodation (financial or otherwise) in respect of the transactions contemplated hereby or the conduct of the business of the Company or its Subsidiaries, Delta or Purchaser (including any agreement not to compete in any geographic area or line of business) or results, or would result in, the abrogation or diminishment of any authority or license granted by any governmental entity, or (z) enter into negotiations with any labor organization representing employees of the Company or any of its Subsidiaries as a condition to consummation of the transactions contemplated by this Agreement.

7.5 Employment Agreements. Prior to the Closing Date, Delta shall have entered into Employment Agreements in the form attached hereto as Exhibit 7.5(a) and Non-Competition Agreements in the form attached hereto as Exhibit 7.5(b) with Steven Klein, Gary Beggs, and Kristina Nettseheim.

7.6 Public Announcements. Until the first public announcement of the transactions contemplated hereby, each of Delta and the Company and their respective



Affiliates agrees that it will not issue any announcements, releases, statements or reports, or confirm any statements by third parties, pertaining to this Agreement or the transactions contemplated hereby, except as: (i) may be required by applicable law, any governmental agency if required by such agency, the rules of the Nasdaq National Market or any Israeli corporate and securities authorities, or (ii) approved by the other party, which approval shall not be unreasonably withheld or delayed; provided, however, that if Delta or Purchaser is required by law to issue any such announcements, Delta shall be entitled to control the timing of any such announcements; provided that in all events Delta shall give the Selling Shareholders three days prior written notice of, and the opportunity to review, any such announcement described by clause (i) or the proviso in clause (ii) above and shall in good faith consider implementing any comments that the Selling Shareholders have with respect to such announcement.

7.7 Expenses. Delta shall be responsible for its fees, costs and expenses incurred in connection with the transaction contemplated hereby and the Selling Shareholders shall be responsible for all fees, costs and expenses incurred by the Selling Shareholders and the Company in connection with the Proposed Transaction, in each case including, but not limited to, any accounting, legal, advisory, commission or fees of any broker or finder referred by them and any investment banking fees incurred in connection with the proposed transaction contemplated hereby. Notwithstanding the foregoing, accounting fees paid or payable to Bowen, Phillips & Carmichael for CFO services up to \$488,000 for the year 2004 will be paid for by the Company (and payment of such \$488,000 shall not cause any reduction in Purchase Price) and any excess will be paid by the Selling Shareholders. The Selling Shareholders and Delta shall each be responsible in equal parts for the fees incurred in relation to all regulatory filings in connection with the transactions contemplated hereby (with the exception of fees incurred in connection with obtaining Israeli approvals, which shall be borne solely by Delta).

7.8 Noncompetition and Confidentiality Agreements. The Company agrees not to, and not to permit its Subsidiaries to, terminate, amend or waive any of the confidentiality and non-competition agreements entered into by its employees and consultants with the Company or any of its Subsidiaries. The Company has heretofore furnished or made available to Delta and Purchaser complete and accurate copies of the confidentiality and non-competition agreements executed by its and its Subsidiaries' employees and consultants.

7.9 Indemnification; Survival of Representations and Warranties.

(a) Subject to the terms and conditions of this Section 7.9 and 7.10 and other than in respect of Environmental Damages for which indemnification shall be had, if at all, exclusively pursuant to Section 7.14, the Selling Shareholders hereby agree to indemnify and save harmless Purchaser and its officers, directors, shareholders, employees and Affiliates from, against, for and in respect of any and all assessments, penalties, losses, damages, liabilities, costs and expense (including court costs, amounts paid in settlement, judgments, reasonable attorneys' fees or other expenses for

investigating and defending), suit, action, claim, liability, obligation, or any Taxes described in Section 7.10(a) (collectively, “Damages”) suffered, sustained, incurred or required to be paid by Delta, the Purchaser, or any of their respective officers, directors, employees or Affiliates as a direct result of the breach of any representation, warranty, covenant or agreement of the Selling Shareholders or the Company contained in or made pursuant to this Agreement; provided, however, that there shall be no liability under this Section 7.9(a) or Section 7.10(a) unless and until the aggregate of all Damages exceed seventy five thousand dollars (\$75,000.00) and then recovery shall be had for each previously or subsequently incurred Damage.

(b) Subject to the terms and conditions of this Section 7.9, Delta and Purchaser hereby agree to indemnify and save harmless the Selling Shareholders from, against, for and in respect of any and all Damages suffered, sustained, incurred or required to be paid by any Selling Shareholder as a direct result of the breach of any representation, warranty, covenant or agreement of Purchaser or Delta contained in or made pursuant to this Agreement, provided that there shall be no liability of Delta or the Purchaser under this Agreement in excess of \$2,250,000, other than for payment of the Purchase Price.

(c) Any party seeking indemnification hereunder (“Indemnified Party”) agrees to give prompt written notice to any indemnifying party (the “Indemnifying Party”) of any claim by a third party that might reasonably be expected to give rise to a claim based on the indemnity agreements contained in Section 7.9(a) or Section 7.9(b) hereof, stating the nature and basis of said claim and the amount thereof, to the extent known, provided, however, that the failure of any Indemnified Party to give timely notice shall not affect its right to indemnification hereunder except to the extent that the Indemnifying Party demonstrates actual damage or prejudice caused by such failure.

(d) In the event the Indemnified Party shall notify the Indemnifying Party of any third-party claim pursuant to subsection (c) hereof, the Indemnifying Party shall defend such claim (including all actions, suits or proceedings and all proceedings on appeal or for review that counsel deem appropriate) with counsel reasonably satisfactory to the Indemnified Party by written notice to the Indemnified Party within thirty (30) days after receipt of such notice. The party defending such claim shall make available to the other party and its attorneys and accountants all books and records relating to such proceedings or litigation, and the parties hereto agree to render to each other such assistance as they may reasonably require of each other in order to ensure the proper and adequate defense of any such action, suit or proceeding. The Indemnified Party shall not compromise such claim without the written consent of the Indemnifying Party (which consent shall not be unreasonably withheld).

(e) In the event that an Indemnified Party shall seek indemnification hereunder with respect to any claims (other than by third parties), the Indemnified Party shall give the Indemnifying Party prompt written notice of such claim, stating the nature and basis of said claim and the amount thereof with specificity, to the extent known. Within thirty (30) days after receipt of such notice, the Indemnifying Party shall either pay the amount of such claim or set forth in writing any dispute with respect to such

claim. If such party shall dispute such claim, no amounts shall be payable with respect to such claim until such dispute shall be resolved.

(f) Except for fraud or breaches of the representations and warranties contained in Sections 4.3 (Capitalization); 4.4 and 5.1 (Authority Relative to this Agreement of the Company and Selling Shareholders, respectively); 4.12 (Taxes and Tax Payments) and 5.2 (Shares of the Company), for which liability shall neither terminate nor be limited, in no event shall the Company and the Selling Shareholders be liable for aggregate Damages exceeding the lesser of \$5,500,000 and any lesser amount then held in the Indemnity Escrow. No Indemnified Party shall have a right to seek indemnification for Damages pursuant to this Section 7.9 or 7.10 at any time after the third anniversary of the date hereof, provided that any claims for indemnification made pursuant to and in accordance with this Section 7.9 or 7.10 that are unresolved at such date shall continue until resolved.

(g) The parties hereto acknowledge and agree that the indemnification provided for in this Section 7.9 and in Section 7.10, subject to the limitations set forth herein, shall be the sole and exclusive remedy of the parties with respect to any matter arising from or related to this Agreement (other than for claims relating to fraud). Notwithstanding the foregoing, nothing in this Agreement shall limit the ability of a party to seek specific performance or other equitable relief in connection with this Agreement.

(h) Other than for any representations and warranties relating to the environmental condition of the Owned Real Property or the Leased Real Property, Regulated Substances, Environmental Permits, compliance with any applicable Environmental Laws, or any liabilities or any impact upon any of the Company's financial statements or books and records related to or arising in connection with any of the foregoing, including without limitation those made in Section 4.16 (all of which shall terminate upon the Closing), the representations and warranties contained herein shall survive the Closing and continue in effect (i) for breaches of Sections 4.3 (Capitalization); 4.4 and 5.1 (Authority Relative to this Agreement of the Company and Selling Shareholders, respectively); 4.12 (Taxes and Tax Payments); and 5.2 (Shares of the Company) without time limitation, and (ii) for all other representations and warranties for the period that ends upon the third anniversary of the Closing Date.

(i) It is expressly understood and agreed that: (i) no Indemnified Party shall be entitled to seek indemnification for Damages with respect to the settlement of the Canadian Customs Matter (referred to in Section 7.13) to the extent it does not exceed \$1,000,000; (ii) no Indemnified Party shall be entitled to seek indemnification for Damages with respect to the Roof Costs (referred to in Section 7.12) to the extent the Roof Costs do not exceed \$2,300,000; and (iii) no Indemnified Party shall be entitled to seek indemnification for Damages with respect to any structural matters or other Indemnified Losses related to the roof on either of the McCormick Building or the Forstmann Building to the extent of any recovery under any warranty issued in connection with the Roof Repairs (referred to in Section 7.12).

#### 7.10 Tax Matters.

(a) Tax Indemnities. Subject to the terms and conditions of Section 7.9, in addition to the indemnification provided under Section 7.9, from and after the Closing Date and until the third anniversary of the Closing Date, the Selling Shareholders shall jointly and severally indemnify and save the Purchaser and the Company harmless from all Damages attributable to (A) federal, state, local and foreign Taxes imposed on Delta, the Purchaser or the Company or any of its Subsidiaries (1) for any period that ends on or before the Closing Date (the “Pre-Closing Period”) (or for any period beginning before and ending after the Closing Date to the extent allocable under Section 7.10(c)(ii) to the portion of such period beginning before and ending on the Closing Date) on account of or with respect to the income, assets or activities of the Company or any such Subsidiary to the extent such Taxes are not reflected in the amount of Company Net Debt, (2) resulting by reason of the several liability of the Company pursuant to Treasury Regulations Section 1.1502-6 or any analogous state, local, foreign law or regulation by reason of the Company being or having been a member of any consolidated, combined or unitary group on or prior to the Closing Date, (3) resulting from the actual or deemed transfer prior to the Closing of assets, properties and businesses by or to the Company, or the consummation prior to the Closing of any other actions or transactions contemplated by this Agreement, or (4) resulting from the breach of any of the Company’s representations and warranties made in Section 4.12, (B) sales or use Taxes payable by the Company or any Subsidiary, or for which the Company has responsibility for withholding and payment, for any Pre-Closing Period, and (C) withholding and payroll Taxes payable by the Company or any Subsidiary, or for which the Company has responsibility for withholding and payment, for any Pre-Closing Period.

(b) Character of Indemnity Payments. All amounts paid pursuant to Section 7.9 and this Section 7.10 by one party to another party (other than interest payments) shall be treated by such parties as an adjustment to the Purchase Price. In the event any taxing authority shall assert, or applicable law shall require, that any amount referred to in the preceding sentence shall be treated as income to the recipient thereof, then the amount of such payment, if, and only if, such payment relates to Taxes, shall be adjusted to reflect the impact of all applicable Taxes so that the recipient, after the impact of all Taxes is taken into consideration, shall be in the same position as it would have been had the event creating the obligation on the part of the payor to make such payment never occurred.

(c) Tax Returns.

(i) Tax Periods Ending on or Before the Closing Date. The Selling Shareholders shall prepare or cause to be prepared and file or cause to be filed all Tax Returns for the Company and its Subsidiaries for all periods ending on or prior to the Closing Date which are filed after the Closing Date. The Selling Shareholders shall permit the Purchaser to review and comment on each Tax Return described in the preceding sentence before filing. The Selling Shareholders agree that any Tax Returns prepared and filed by the Selling Shareholders will be prepared and filed on a consistent basis with the most recent

such Tax Returns, unless the Selling Shareholders conclude that there is no reasonable basis for such position.

(ii) Tax Periods Beginning Before and Ending After the Closing Date. The Purchaser shall prepare or cause to be prepared and file or cause to be filed all Tax Returns for the Company and its Subsidiaries for all periods that begin before the Closing Date and end after the Closing Date. The Purchaser shall permit the Selling Shareholders to review and comment on each Tax Return described in the preceding sentence before filing. The Purchaser agrees that any Tax Returns prepared and filed by the Purchaser for periods that begin before the Closing Date and end after the Closing Date will be prepared and filed on a consistent basis with the most recent such Tax Returns, unless the Purchaser concludes that there is no reasonable basis for such position. The Selling Shareholders shall reimburse the Purchaser for Taxes of the Company and its Subsidiaries with respect to such periods within fifteen (15) days after payment by the Purchaser or the Company and its Subsidiaries with respect to the amount of such Taxes that relate to the portion of the Tax period ending on the Closing Date to the extent such Taxes are not reflected in Company Net Debt. For purposes of this Section, in the case of any Taxes that are imposed on a periodic basis and are payable for a Tax period that includes (but does not end on) the Closing Date, the portion of such Tax that relates to the portion of such Tax period ending on the Closing Date shall (x) in the case of Taxes other than Taxes based upon or related to income or receipts, be deemed to be the amount of such Tax for the entire Tax Period multiplied by a fraction the numerator of which is the number of days in the Tax period ending on the Closing Date and the denominator of which is the number of days in the entire Tax period, and (y) in the case of any Tax based upon or related to income or receipts, be deemed equal to the amount that would be payable if the relevant Tax period ended on the Closing Date. Any credits relating to a Tax period that begins before and ends after the Closing Date shall be taken into account as though the relevant Tax period ended on the Closing Date. All determinations necessary to give effect to the foregoing allocations shall be made in a manner consistent with prior practice of the Company and its Subsidiaries.

(d) Section 338(h)(10) Election.

(i) At the Purchaser's option, the Purchaser and the Selling Shareholders shall jointly make an election under Code Section 338(h)(10) (and any corresponding election under state, local and foreign Tax law) (a "Section 338(h)(10) Election") with respect to the purchase and sale of the Company Capital Stock hereunder. Purchaser shall exercise its option to make the Section 338(h)(10) Election by delivering notice to the Selling Shareholders not later than April 1, 2005. In the event that the Purchaser exercises its option to make the Section 338(h)(10) Election, the Purchaser and the Selling Shareholders agree to report the transfers under this Agreement consistent with the Section 338(h)(10) Election.

(ii) The Purchaser shall be responsible for the preparation and filing of all documents and forms related to the Section 338(h)(10) Election, including Form 8023, in accordance with applicable Tax laws. The Purchaser shall deliver such documents and forms to the Selling Shareholders in a form suitable for execution at least forty five (45) days prior to the date such documents or forms are required to be filed, and the Selling Shareholders shall execute such documents or forms and deliver said executed documents or forms to the Purchaser on or before the later of (A) twenty (20) days prior to the date such forms are required to be filed or (B) five (5) days after the Shareholders Representative receives the payment pursuant to Section 7.10(d)(iv) below.

(iii) The Purchase Price shall be allocated among the assets of the Company in accordance with the mutual agreement of the parties to be reached at least sixty (60) days prior to the due date for filing any documents and forms related to the Section 338(h)(10) Election. Purchaser shall propose an allocation and provide a copy of such allocation to the Seller Representative prior to the due date of the first such Return, allowing the Sellers a reasonable time during which to review such allocation. Purchaser and the Sellers agree to cooperate to resolve any disputes regarding such allocation prior to the due date for filing such Returns. Subject to the requirements of any applicable Tax laws, all Tax Returns filed by the Purchaser, the Company and the Selling Shareholders shall be prepared consistently with such allocation. In the event of any Purchase Price adjustment hereunder, the Purchaser and the Selling Shareholders agree to adjust such allocation to reflect such Purchase Price adjustment and to file consistently any Tax Returns required as a result of such Purchase Price adjustment.

(iv) In the event that the Purchaser elects to make the Section 338(h)(10) Election, the Company shall pay to the Selling Shareholders an amount necessary, after payment of Tax on such amount, to pay any increased Tax liability for the Selling Shareholders resulting from the Section 338(h)(10) Election, including without limitation any penalties for failure to pay estimated Tax or failure to pay Tax shown on the Selling Shareholders' Tax returns, based on the allocation of Purchase Price agreed to by the parties pursuant to Section 7.10(d)(iii). Purchaser shall make such payment to the Selling Shareholders at least forty-five (45) days prior to the date that the documents or forms related to the Section 338(h)(10) Election are required to be filed. If Purchaser shall fail to make such payment to the Selling Shareholders by April 1 of any year in which such payments are payable, then such unpaid amounts shall accrue interest at 10% per annum.

(v) Subject to the terms and conditions of Section 7.9, in addition to the indemnification provided under Section 7.9, from and after the Closing Date, the Company shall indemnify and save each Selling Shareholder harmless from all Damages attributable to federal, state, local and foreign Taxes imposed on such Selling Shareholder on account of the Section 338(h)(10) Election to the extent

that such Taxes were not accounted for in the determination of the payment pursuant to Section 7.10(d)(iv).

(e) Miscellaneous.

(i) Prior Tax Sharing Agreements. Any and all other tax sharing or allocation agreements, if any, in effect on the Closing Date as to which the Company is or was a party, for all Taxes imposed by any federal, state, foreign or local government or taxing authority, regardless of the period for which such Taxes are imposed, shall be terminated as of the Closing Date and, after the Closing Date the Company and its Subsidiaries shall not be bound thereby or have any liability thereunder.

(ii) Survival of Claims. Notwithstanding any other provision of this Agreement, no claim for indemnification under this Section 7.10 may be made in respect of any Tax that is asserted by any taxing authority after the applicable statute of limitations period with respect to such Tax has expired, except for a claim for indemnification for the cost of contesting such assertion.

(iii) Cooperation on Tax Matters.

(A) Each of Delta, Purchaser, the Selling Shareholders and the Company shall cooperate fully, as and to the extent reasonably requested by the other Party, in connection with the filing of Tax Returns pursuant to this Section 7.10 and any audit, litigation or other proceeding with respect to Taxes. Such cooperation shall include the retention (for a reasonable period of time, but not less than six years after the Closing Date) and (upon the other Party's request) the provision of records and information that are reasonably relevant to any such audit, litigation or other proceeding and making employees available on a mutually convenient basis to provide additional information and explanation of any material provided hereunder.

(B) Each of Delta, Purchaser, the Selling Shareholders and the Company further agree, upon request, to use their reasonable, best efforts to obtain any certificate or other document from any governmental authority or any other Person as may be necessary to mitigate, reduce or eliminate any Tax that could be imposed (including, but not limited to, with respect to the transactions contemplated hereby).

(iv) Certain Taxes. All transfer, documentary, sales, use, stamp, registration and other Taxes (excluding any Taxes incurred by Selling Shareholders due to the transactions contemplated hereby) and fees (including penalties and interest) incurred in connection with the transfer of Company Capital Stock pursuant to this Agreement shall be borne fifty percent (50%) by the Selling Shareholders and fifty percent (50%) by the Purchasers. The Selling Shareholders shall, with expenses borne fifty percent (50%) by the Selling Shareholders and fifty percent (50%) by the Purchasers, file all necessary Tax

Returns and other documentation with respect to such transfer, documentary, sales, use, stamp, registration and other Taxes and fees, and if required by applicable law, the Purchaser will join in the execution of any such Tax Returns and other documentation.

(v) Prior Return Amendment. Each of Delta and Purchaser agree to not amend any Tax Returns filed by the Company relating to tax periods beginning before the Closing Date without the Selling Shareholder's written consent or except as required by a Federal, state, local or other relevant taxing authority.

7.11 Notice and Cure. Each party to this Agreement shall promptly and in writing provide each other party hereto with true and complete copies of, any and all information or documents relating thereto to, as promptly as practicable and in any event before the Closing, any event, transaction or circumstance occurring after the date hereof that causes or will cause any covenant or agreement of such notifying party to be materially breached or that renders or will render any representation or warranty of such notifying party contained in this Agreement to be untrue in any material respect. Each party shall also use its reasonable best efforts to cure, as promptly as practicable and in any event before the Closing, any material violation or breach of any representation, warranty, covenant or agreement made by such notifying party (unless the relevant representation, warranty, covenant or agreement is already subject to a materiality qualification, in which case the notifying party shall also provide notice and so attempt to cure, in the event of any violation or breach), whether occurring or arising before, on or after the date of this Agreement. In the event notice is given pursuant to this Section 7.11 and a Closing occurs, the effect of such notice shall be to eliminate any recourse that the party being so notified shall have to seek indemnity hereunder; provided, however, nothing contained in this Section 7.11 shall limit the right of any party receiving such notice to terminate this Agreement in accordance with Section 9.1 hereof.

7.12 Roof Repairs and Related Matters. The Selling Shareholders shall have the right and authority to bid out the work necessary to repair the roof at the McCormick Building and at the Forstmann Building (the "Roof Repairs") and provided that (i) the relevant contractor is appropriately licensed, (ii) the relevant contractor and his scope of work is reasonably acceptable to Purchaser, and (iii) such contractor provides a written five year warranty reasonably satisfactory to Purchaser upon completion of the related roof repairs, the Selling Shareholders shall have the authority to bind the Company to a written contract in connection therewith. To the extent that the costs incurred by the Company for the Roof Repairs is less than \$2,300,000, Delta will pay over to the Selling Shareholders as additional consideration for the Company Capital Stock an amount equal to the difference between \$2,300,000 and the cost of such Roof Repairs. For a period of five years after the Closing Date, the Selling Shareholders shall have the right to cause the Company to enter into a real estate brokerage and listing agreement with a company reasonably satisfactory to the Purchaser for the purpose of selling the Excess Land as defined in Annex 2 to this Agreement. The Selling Shareholders shall also have the right and authority to bind the Company to any sale of such Excess Land, provided, that the Selling Shareholders shall offer the Purchaser in writing the right of first refusal for a



period of ten (10) days from the date of receipt of such written notice to purchase such Excess Land under the same terms and conditions as agreed to by the prospective purchaser, all of which shall be disclosed in such writing to the Purchaser. If the Purchaser elects to so purchase such Excess Land, the purchase price therefor shall include the reasonable transaction expenses incurred by the Selling Shareholders in connection therewith. If the Excess Land is contracted for sale during such time period and the sale pursuant thereto is consummated within six months of the date of contract, then the first \$750,000 of the sales proceeds of the Excess Land less real estate brokerage commissions (the “Net Proceeds”) shall belong to and be the property of the Company. If the Net Proceeds exceed \$750,000, the Net Proceeds in excess of \$750,000 up to a maximum amount equal to one half of the Roof Costs shall be paid over to the Selling Shareholders, with any remaining amount retained by the Company. Any such payment due to the Selling Shareholders shall be due and payable on the closing date of the sale of the Excess Land.

7.13 Control of CCRA Investigation; Settlement. Any investigation relating to any period prior to the Closing by the Canadian Customs’ and Revenues Agency (“CCRA”) and any negotiations with and settlement of any such investigation shall be controlled by the Selling Shareholders, who shall have the right and authority to bind the Company with respect to such matters, provided that the total amounts, if any, payable to the CCRA as a result of any such investigation do not exceed the equivalent of US\$\*\*\*\*\*. To the extent that the settlement of such claims by the CCRA is less than \$\*\*\*\*\*, Delta will pay over to the Selling Shareholders as additional consideration for the Company Capital Stock an amount equal to the difference between \$1,000,000 and the amount paid in settlement to the CCRA.

7.14 Environmental Indemnification.

(a) Subject to the terms and conditions of this Section 7.14, the Selling Shareholders hereby agree to indemnify and save harmless Purchaser and its officers, directors, shareholders, employees and Affiliates from, against, for and in respect of any and all assessments, penalties, losses, damages, liabilities, costs and expense (including court costs, amounts paid in settlement, judgments, reasonable attorneys’ fees or other expenses for investigating and defending), suit, action, claim, liability, or obligation (collectively, “Environmental Damages”) suffered, sustained, incurred or required to be paid by Delta, the Purchaser, or any of their respective officers, directors, employees or Affiliates as a result of the presence of any Hazardous Substances in structures, soil, surface water or groundwater at the Real Property prior to Closing; provided, however, that there shall be no liability under this Section 7.14(a) unless and until the aggregate of all Environmental Damages exceed fifty thousand dollars (\$50,000.00) and then recovery shall be had for each previously incurred and subsequent Damage.

For purposes of this Section 7.14, the term “Hazardous Substances” shall mean any and all petroleum products, asbestos, hazardous waste, material, substance or pollutant as defined within or governed by CERCLA (42 U.S.C. §§ 9601 et seq.), RCRA (42 U.S.C. §§ 6901 et seq.), HSRA (O.C.G.A. §§ 12-8-90 et seq.), HWMA (O.C.G.A. §§ 12-8-60 et seq.) and the respective rules and regulations of each.

(b) No party shall be entitled to indemnification hereunder for any Environmental Damages arising from or pertaining to Hazardous Substances discovered or identified as a result of any soil, groundwater or surface water sampling or analysis at or near the Real Property, performed by, on behalf of, or allowed to be conducted by Purchaser or its officers, directors, shareholders, employees or Affiliates, unless such sampling or analysis is: (i) expressly required by law or regulation or ordered by a governmental entity with authority to require such sampling; (ii) performed by a prospective purchaser of any Real Property, provided that Purchaser has first entered into a binding sales contract with the prospective purchaser regarding such Real Property; or (iii) required by a commercial lender as a condition of the grant of any loan or line of credit with respect to the Business or the Real Property; provided, however, that Purchaser must provide Selling Shareholders with at least twenty (20) days written notice and opportunity to object prior to conducting or allowing any sampling or analysis pursuant to the above subsections (i), (ii) or (iii).

(c) In addition, no party shall be entitled to indemnification hereunder for any Environmental Damages (i) arising from or pertaining to Hazardous Substances discovered or identified as a result of (i) any notification by or on behalf of Purchaser or its officers, directors, shareholders, employees or Affiliates with any governmental entity regarding the release, presence, or the potential or suspected release or presence of Hazardous Substances at the Real Property, except as expressly required by applicable Environmental Law; (ii) any contact initiated by or on behalf of Purchaser or its officers, directors, shareholders, employees or Affiliates for the purpose or with the intent of, notifying or advising any governmental entity regarding the release, presence, or the potential or suspected release or presence of Hazardous Substances at the Real Property, except as expressly required by applicable Environmental Law; or (iii) to the extent Environmental Damages are the result of any release of Hazardous Substances or noncompliance with any Environmental Law at the Real Property after Closing.

(d) Should Purchaser or the Company seek to sell any portion of the Owned Real Property other than the Excess Land at any time, Purchaser or the Company shall offer Selling Shareholders in writing the right of first refusal for a period of ten (10) days from the date of receipt of such written notice to purchase such Owned Real Property under the same terms and conditions as agreed to by the prospective purchaser, all of which shall be disclosed in such writing to the Selling Shareholders. If the Selling Shareholders elect to so purchase such Owned Real Property, the purchase price therefor shall include the reasonable transaction expenses incurred by Purchaser or the Company in connection therewith, including without limitation any reasonable payments from Purchaser or the Company to such prospective purchaser. Should Purchaser fail to offer Selling Shareholders the right of first refusal pursuant to this Section 7.14(d) for any portion of the Real Property, Purchaser shall lose all right to claim indemnification pursuant to Section 7.14(a) regarding that portion of the Real Property, and shall be solely responsible for any Environmental Damages arising from or pertaining to Hazardous Substances discovered or identified as a result of any soil, groundwater or surface water sampling or analysis conducted by such prospective purchaser.

(e) Any party seeking indemnification hereunder (“Environmental Indemnified Party”) agrees to give prompt written notice to any indemnifying party (the “Environmental Indemnifying Party”) of any claim by a third party that might reasonably be expected to give rise to a claim based on the indemnity agreement contained in Section 7.14(a) hereof, stating the nature and basis of said claim and the amount thereof, to the extent known, provided, however, that the failure of any Environmental Indemnified Party to give timely notice shall not affect its right to indemnification hereunder except to the extent that the Environmental Indemnifying Party demonstrates actual damage or prejudice caused by such failure.

(f) In the event that an Environmental Indemnified Party shall seek indemnification hereunder with respect to any claims, the Environmental Indemnified Party shall give the Environmental Indemnifying Party prompt written notice of such claim, stating the nature and basis of said claim and the amount thereof with specificity, to the extent known. Within thirty (30) days after receipt of such notice, the Environmental Indemnifying Party shall either pay the amount of such claim or set forth in writing any dispute with respect to such claim. If such party shall dispute such claim, no amounts shall be payable with respect to such claim until such dispute shall be resolved.

(g) In no event shall the Company and the Selling Shareholders be liable for aggregate Environmental Damages that exceed the lesser of \$5,500,000 and any lesser amount then held in the Indemnity Escrow the amount of the Escrow Indemnity then held. The indemnity obligations contained in this Section 7.14 shall terminate upon termination of the Escrow Period.

(h) The parties hereto acknowledge and agree that the indemnification provided for in this Section 7.14, subject to the limitations set forth herein, shall be the sole and exclusive remedy of the parties with respect to any matter arising from or related to any Environmental Damages.

7.15 Conduct of Business by the Company. During the period from the Closing and continuing until December 31, 2004, without the consent of Delta and Purchaser, the Selling Shareholders shall take no action to cause the business of the Company to be conducted other than in the ordinary and usual course of business and consistent with past practices.

7.16 Assignment of Automobile Leases. The Selling Shareholders shall cause the automobile leases listed on Schedule 7.16 to be assigned to the persons identified opposite such leases on such Schedule by February 28, 2005. The Selling Shareholders shall bear the cost to the Company, if any, from such assignment.

7.17 Additional Actions.

(a) The Selling Shareholders shall use reasonable efforts to obtain the consent of Stony Apparel Corp. to the transaction contemplated hereby as required by the License dated July 2, 2003 by and between the Company and Stony Apparel Corp.

(b) The Company shall provide all notices required under the agreements related to the IRB Debt to allow for the early prepayment of the IRB as soon as reasonably practicable after the Closing, but in no event later than February 28, 2005.

(c) The excess of any amounts in the LC Payment Account over amounts credited against such account by Bank of America pursuant to that certain letter of even date herewith related to the Credit Agreement Documents, Business Loan Documents and Agreement regarding LC Payment Account (as defined therein) shall be paid over to the Selling Shareholders within ten (10) Business Days after the final determination thereof.

## ARTICLE VIII

### CONDITIONS TO CLOSING

8.1 Conditions to Each Party's Obligation to Affect the Purchase. The respective obligations of each party to effect the transactions contemplated hereby shall be subject to the satisfaction, at or prior to the Closing Date, of the following conditions, any one of which may be waived by a writing signed by each of the Company, the Selling Shareholders and Delta:

(a) No preliminary or permanent injunction or other order by any federal, state or foreign court of competent jurisdiction that prohibits the consummation of the Closing shall have been issued and remain in effect. No statute, rule, regulation, executive order, stay, decree, or judgment shall have been enacted, entered, issued, promulgated or enforced by any court or governmental authority which prohibits or restricts the consummation of the transactions contemplated hereby. All authorizations, consents, orders or approvals of, or declarations or filings with, and all expirations of waiting periods imposed by, any governmental entity, including, without limitation, the expiration or termination of the waiting period applicable under the H-S-R Act (all of the foregoing, "Consents") that are necessary for the consummation of the transactions contemplated hereby, other than Consents of which the failure to obtain would not materially, adversely affect the consummation of the transactions contemplated hereby or in the aggregate have a Material Adverse Effect on any party hereto, shall have been filed, occurred or been obtained (all such permits, approvals, filings and consents and the lapse of all such waiting periods being referred to as the "Requisite Regulatory Approvals") and all such Requisite Regulatory Approvals shall be in full force and effect.

(b) There shall be no action taken, or any statute, rule, regulation or order enacted, entered, enforced or deemed applicable to the transactions contemplated hereby, by any federal, or state governmental entity that, in connection with the grant of a Requisite Regulatory Approval, imposes any condition or restriction upon any of the

parties hereto, which in any such case would materially adversely impact the economic or business benefits of the transactions contemplated by this Agreement.

(c) The Employment Agreements and the Non-Competition Agreements referred to in Section 7.5 hereof shall have been executed and delivered by the parties thereto other than Purchaser or Delta.

(d) The Outstanding Term Loan shall have been paid by Delta or the Purchaser. An amount in cash equal to the IRB Debt shall have been deposited with SunTrust Bank, as the issuer of the Letter of Credit securing the IRB Debt.

8.2 Conditions to Obligation of the Selling Shareholders to Effect the Purchase. The obligation of the Selling Shareholders to effect the transactions contemplated hereby shall be further subject to the satisfaction at or prior to the Closing Date of the following additional conditions, any of which may be waived by the Selling Shareholders in writing:

(a) Each of Delta and Purchaser shall have performed in all material respects its obligations under this Agreement required to be performed by it at or prior to the Closing Date;

(b) The representations and warranties of Delta and Purchaser contained in this Agreement shall be true and correct in all material respects at and as of the Closing Date as if made at and as of such time, except as contemplated by this Agreement; and

(c) The Company shall have received a certificate signed by the President, any Vice President or the Chief Financial Officer of Delta as to the satisfaction of the conditions set forth in Sections 8.2(a) and (b).

(d) There shall not have occurred following the date of this Agreement and prior to the Closing Date any change, or any event involving a prospective change, in Delta's or any of its Subsidiaries' business, assets, financial condition or results of operations that has had, or is reasonably likely to have, a Material Adverse Effect.

(f) The Selling Shareholders shall not discover any matter not disclosed or made available to them as of the date hereof, which matter could reasonably be expected to have a Material Adverse Effect on Delta or any of its Subsidiaries.

(g) The Selling Shareholders shall have received an opinion, dated as of the Closing, from Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co., counsel for Delta and the Purchaser, substantially in the form attached hereto as Exhibit 8.2(g).

8.3 Conditions to Obligations of Delta and Purchaser to Effect the Purchase. The obligations of Delta and Purchaser to effect the transactions contemplated hereby shall be further subject to the satisfaction at or prior to the Closing Date of the following additional conditions, any of which may be waived by Delta in writing:

(a) The Company shall have performed in all material respects its obligations under this Agreement required to be performed and complied with by it at or prior to the Closing Date and the representations and warranties of the Company and the Selling Shareholders contained in this Agreement shall be true and correct in all material respects (except any representation or warranty that by its terms is qualified by materiality or Material Adverse Effect, which shall be true and correct in all respects), at and as of the Closing Date as if made at and as of such time, except as contemplated by this Agreement, and Delta and Purchaser shall have received a certificate signed by the President or any Vice President of the Company as to the satisfaction of this condition.

(b) The Company shall have obtained and delivered to Delta and Purchaser the consents or approvals set forth on Schedule 8.3(b) hereto.

(c) Delta and Purchaser shall have received an opinion, dated as of the Closing, of Kilpatrick Stockton LLP, counsel for the Company, substantially in the form attached hereto as Exhibit 8.3(c).

(d) There shall not have occurred following the date of this Agreement and prior to the Closing Date any change, or any event involving a prospective change, in the Company's or its Subsidiaries' business, assets, financial condition or results of operations that has had, or is reasonably likely to have, a Material Adverse Effect (provided, however, that any adverse change resulting solely from conditions affecting the United States or any foreign economy generally that do not disproportionately affect the business of the Company shall not be taken into account in determining whether there has been or would be a "Material Adverse Effect").

(e) Each Selling Shareholder shall execute and deliver to Delta an Investor Representation letter (in the form attached hereto as Exhibit 8.3(e)) relating to certain United States securities laws.

## ARTICLE IX

### TERMINATION, AMENDMENT AND WAIVER

9.1 Termination. This Agreement may be terminated and the transactions contemplated hereby abandoned at any time prior to the Closing Date (each such event, a "Termination"):

(a) by mutual written consent of Delta, Purchaser, the Selling Shareholders and the Company;

(b) by (i) either Delta and Purchaser, on the one hand, or the Selling Shareholders, on the other hand, if the Closing shall not have been consummated on or before December 31, 2004; or (ii) the Selling Shareholders if there shall have been any material breach of a representation and warranty or material obligation of Delta or Purchaser hereunder, and, if such breach is curable, such default shall have not been remedied within ten (10) days after receipt by Delta of notice in writing from the Selling

Shareholders specifying such breach and requesting that it be remedied, provided that the terminating party is not in material default of any of its obligations hereunder;

(c) by Delta and Purchaser if there shall have been any material breach of a representation and warranty or material obligation of the Company or any Selling Shareholder hereunder, and, if such breach is curable, such default shall not have been remedied within ten (10) days after receipt by the Company and the Selling Shareholders of notice in writing from Delta or Purchaser specifying such breach and requesting that it be remedied, provided that the terminating party is not in material default of any of its obligations hereunder;

(d) by either Delta, the Company, or the Selling Shareholders if any court of competent jurisdiction in the United States or Israel or other United States or Israeli governmental body shall have issued an order, decree or ruling or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated hereby (or the issuance of the Ordinary Shares) and such order, decree, ruling or any other action shall have become final and non-appealable; provided that the party seeking to terminate this Agreement pursuant to this clause (d) shall have used all reasonable efforts to remove such order, decree or ruling;

(e) by either Delta or Purchase in accordance with Section 6.5(c).

9.2 Effect of Termination. In the event of Termination under Section 9.1(a), (b)(i), (c)(i), (d), or (e) hereof, this Agreement shall forthwith become of no further effect and, there shall be no liability or obligation on the part of either Delta, Purchaser, the Company or the Selling Shareholders or their respective officers or directors.

## ARTICLE X

### GENERAL PROVISIONS

10.1 [Intentionally Omitted.]

10.2 Notices. All notices, claims, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally, by telecopy, mailed by registered or certified mail (postage prepaid, return receipt requested), or delivered by internationally recognized courier to the respective parties at the following addresses (or at such other address for a party as shall be specified by like notice):

If to Delta or Purchaser, to:

Delta Galil Industries Ltd.  
2 Kaufman Street  
Tel Aviv, Israel  
Fax: 972-3-519-3790  
Attention: Arnon Tiberg  
President and Chief Executive Officer

with a copy (which shall not constitute notice) to:

Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co.  
1 Azrieli Center  
Tel Aviv 68021 Israel  
Fax: 972-3-607-4411  
Attention: Daniel K. Gamulka, Esq.

If to the Selling Shareholders, to:

Steven A. Klein  
9 Vista Drive  
Laurel Hollow, NY 11791

with a copy (which shall not constitute notice) to:

Kilpatrick Stockton LLP  
Suite 2800  
1100 Peachtree Street  
Atlanta, GA 30309-4530  
Fax: (404) 541-3157  
Attention: Gregory K. Cinnamon, Esq.

The parties hereto agree that notices or other communications that are sent in accordance herewith (i) by personal delivery or by telecopy will be deemed received on the day sent (with electronic confirmation of receipt in the case of telecopy) or on the first business day thereafter if not sent on a business day, (ii) by registered or certified mail, will be deemed received five (5) business days immediately following the date sent and (iii) by internationally recognized courier, will be deemed received two (2) business days after deposit with such courier.

10.3 Descriptive Headings. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

10.4 Entire Agreement; Assignment. This Agreement (including the Exhibits, Schedules and other documents and instruments referred to herein): (a) constitutes the entire agreement and supersedes all other prior agreements and understandings both written and oral, among the parties or any of them, with respect to the subject matter hereof; (b) is not intended to confer upon any other person any rights or remedies hereunder; and (c) shall not be assigned by operation of law or otherwise, *provided* that Delta or Purchaser may assign its rights and obligations hereunder to a direct or indirect United States subsidiary of Delta, but no such assignment shall relieve Delta or Purchaser, as the case may be, of its obligations hereunder. Terms defined in this Agreement shall have the same meanings when used in the Schedules attached to this Agreement unless the context requires otherwise.



10.5 Governing Law; Procedural Matters. Except as otherwise provided in Section 10.14, this Agreement shall be governed by and construed in accordance with the laws of the State of New York. Each of the parties hereto hereby further irrevocably consents to the service of process in any such suit, action or proceeding in said courts by the mailing thereof by any other party by registered or certified mail, postage prepaid, to such party at its address for notice specified in Section 10.2 hereof. Each of the parties hereto hereby irrevocably waives any objection which it may now or hereafter have to laying of venue of any suit, action or proceeding arising out of or relating to the enforcement of this Agreement brought in state or federal court situated in the State of New York, and hereby further irrevocably waives any claim that any such suit, action or proceeding brought in any such court has been brought in an inconvenient forum.

10.6 Parties in Interest. Nothing in this Agreement, express or implied, is intended to or shall confer upon any other person any rights, benefits or remedies of any nature whatsoever or by reason of this Agreement.

10.7 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original but all of which shall constitute one and the same agreement.

10.8 Validity. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provisions of this Agreement, which shall remain in full force and effect.

10.9 Investigation. The respective representations and warranties of Delta, Purchaser, the Company and the Selling Shareholders contained herein or in the certificates or other documents delivered at or prior to the Closing shall not be deemed waived or otherwise affected by any investigation made by any party hereto.

10.10 Remedies. The parties agree that irreparable damage would result if any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in any court of the United States or New York state court, in either case located in the County of New York, this being in addition to any other remedy to which the parties are entitled at law or in equity.

10.11 Consents; Actions by Selling Shareholders. For purposes of any provision of this Agreement requiring, permitting or providing for consent of Delta, or the Company, the written consent of the Chief Executive Officer, President or Chief Financial Officer of Delta or the Company, as the case may be, shall be sufficient to evidence such consent. For purposes of any provision of this Agreement requiring or providing for the consent, approval, waiver or any other action by the Selling Shareholders, such action shall be considered valid and binding if taken or approved by Steven Klein. Delta and the Purchaser shall be entitled to rely on the written certification of Steven Klein as to the taking of any such action by the Selling Shareholders. Each of Gary Beggs and Kristina Nettesheim irrevocably constitutes and appoints Steven Klein as

such Selling Shareholder's true and lawful attorney-in-fact and agent and authorizes him to acting for such Selling Shareholder and in such Selling Shareholder's name, place and stead, in any and all capacities to do and perform every act and thing required or permitted to be done in connection with the transactions contemplated by this Agreement, as fully to all intents and purposes as such Selling Shareholder might or could do in person.

10.12 Knowledge; No Personal Liability. As used in this Agreement or the instruments, certificates or other documents required hereunder, the term "Knowledge" shall mean actual knowledge of a fact. With respect to the Company, "Knowledge" shall mean actual knowledge of a fact by Steven Klein, L.A. Bowen Jr., Gary Beggs, Kristina Nettesheim, David Hightower (only with respect to Sections 4.11 and 4.14), or Lisa Young, and the knowledge that such person reasonably would be expected to have in the normal discharge of his or her assigned duties without any duty of independent investigation. With respect to Delta or Purchaser, "Knowledge" shall mean actual knowledge of a fact by any officer thereof and the knowledge that such person reasonably would be expected to have in the normal discharge of his or her assigned duties without any duty of independent investigation.

10.13 Amendment; Extension; Waiver. At any time prior to the Closing Date, the parties hereto may, to the extent not inconsistent with applicable law: (a) extend the time for the performance of any of the obligations or other acts of the other parties hereto, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto; (c) waive compliance with any of the agreements or conditions contained herein; or (d) amend this Agreement in any respect. Any agreement on the part of a party hereto to any such extension, waiver or amendment shall be valid only if set forth in an instrument in writing signed on behalf of such party. Such waiver shall not operate as a waiver of, or estoppel with respect to, any subsequent or other failure.

10.14 Dispute Resolution.

(a) Applicability of Dispute Resolution Provisions. The dispute resolution provisions of this Section 10.14 shall apply to any and all disputes or disagreements between or among the Parties relating to or arising out of any provision of this Agreement or any provision of the Escrow Agreement (attached hereto as Exhibit 1.3), regardless of whether the applicability of this Section 10.14 is expressly mentioned in the provisions of this Agreement to which such dispute or disagreement relates.

(b) Good Faith Resolution. The Parties shall attempt to settle amicably by good faith discussions any dispute or disagreement between them relating to or arising out of any provision of this Agreement. If the Parties are unable to resolve the dispute or disagreement by such discussions within five (5) days, then each entity involved in the dispute or disagreement shall refer the dispute or disagreement for resolution to a designated officer.

(c) Arbitration. If the Parties are unable to resolve any such dispute or disagreement within five (5) days after the referral of such dispute or disagreement to their designated officers, then either Party shall have the right to demand that such dispute or disagreement be settled by final and binding arbitration in accordance with the procedures set forth in this Section 10.14.

(i) Location. The location of any arbitration shall be New York, New York.

(ii) Rules Governing Arbitration. The parties agree that any arbitration shall be conducted pursuant to the rules of the American Arbitration Association.

(iii) Number and Appointment of Arbitrators. If the Parties so agree within fifteen (15) days of demand for arbitration, the arbitration shall be conducted by a single independent and disinterested arbitrator agreed upon by the Parties. If the parties cannot jointly select a single arbitrator to determine the matter, one arbitrator shall be chosen by each party (or, if a party fails to make a choice within fifteen (15) days, by the American Arbitration Association on behalf of such party) and the two arbitrators so chosen will select a third.

(iv) Enforceability of Rulings. The Parties agree to be bound by any ruling in such arbitration proceeding and that such ruling shall be enforceable in any court that is of competent jurisdiction and is selected in accordance with Section 10.5 of this Agreement.

(v) Fees. Each entity involved in the arbitration shall bear its own costs and attorney's fees, and shall share equally in the fees and expenses of the arbitrator; provided, however, that the arbitrator will be entitled to make an award or include in any award the requirement that one party pay all or part of the fees and expenses related to the arbitration of the other party.

(c) Specific Performance and Equitable Relief. Nothing in this Agreement, including this Section 10.14, shall prevent any party from seeking performance or other equitable relief in any court of competent jurisdiction.

[Remainder of this page intentionally left blank.]

IN WITNESS WHEREOF, the Selling Shareholders have executed this Agreement and each of Delta, Purchaser, and the Company has caused this Stock Purchase Agreement to be executed on its behalf by its officers thereunto duly authorized, all as of the date first above written.

DELTA GALIL INDUSTRIES LTD.

By: \_\_\_\_\_  
Name:  
Title:

DELTA GALIL USA, INC.

By: \_\_\_\_\_  
Name:  
Title:

BURLEN CORP.

By: \_\_\_\_\_  
Name:  
Title:

Selling Shareholders:

By: \_\_\_\_\_ Address:  
Name: Steven A. Klein

By: \_\_\_\_\_ Address:  
Name: Gary Beggs

By: \_\_\_\_\_ Address:  
Name: Kristina Nettesheim

**SCHEDULE 2.2(c)**

**Purchase Price**

<u>Selling Shareholder</u>	<u>Proportion of Shareholdings</u>	<u>Amount of Cash due Selling Shareholder**</u>	<u>Number of Ordinary Shares</u>
Steven Klein	95%	\$45,537,141.07	204,900
Gary Beggs	2.5%	\$1,198,345.82	5,392
Kristina Nettesheim	2.5%	\$1,198,345.82	5,392

\*\* Includes amounts subject to escrow and amounts disbursed to third parties on Selling Shareholder's behalf.

## **ANNEX 1**

### **EBIT**

EBIT shall mean earnings before interest and taxes, as defined under GAAP, with the following additional adjustments:

1. Any increase in asset basis from purchase price allocation and additional amortization of transaction related employment contracts and other intangibles.
2. Additional corporate overhead allocations due to change in ownership and governance if acquisition related
3. Additional costs due to SEC regulatory compliance and reporting (such as internal control evaluations required by the Sarbanes-Oxley Act)
4. Increased costs, if any, due to changes in employee benefits if required by law to bring current Burlen benefits into ERISA compliance with Purchaser's benefits, excluding any benefits that may accrue to the Selling Shareholders
5. Increased costs for information systems which are primarily due to migrating current systems to Purchaser's information systems (to the extent such increased costs have an impact on Burlen's EBIT above \$50,000)
6. Corporate allocations for overhead

No adjustments will be made for costs associated with Burlen's conforming with Purchaser's accounting policies.

The use of shared corporate services of Delta and the use by Delta of Burlen facilities (such as the elastics factory, distribution etc.) shall be priced consistent with Delta's current practices for inter-divisional charges, and shall not be considered an adjustment to EBIT. If profits are derived by Burlen from such activities such profits should be deducted against the above add-backs. Such calculations will be agreed between Sonny Bowen, who will represent Steve Klein, and the CFO of Delta Galil or Delta Galil USA.

## **ANNEX 2**

### **EXCESS LAND**

56.602 acres of land located in Land Lot 307 of the 6<sup>th</sup> Land District of Tift County, Georgia more fully described as follows: BEGIN at the intersection of the East margin of Carpenter Road (100' R/W) and the South margin of the Old Seaboard Coastline Railroad (100' R/W) and run North 58° 35' 45" East (along the South margin of such Railroad R/W) 2224.48 feet; thence South 27° 29' 33" East 1120.09 feet to the North margin of Hunt Road; thence Southwestward (along the North margin of Hunt Road) 2409.79 feet; thence North 21° 20' 58" west 207.16 feet; thence South 72° 12' 46" West 173.62 feet to the East margin of Carpenter Road; thence Northward (along the East margin of Carpenter Road) 756.18 feet to the point of beginning, and shown as Tract 1 on a Survey made for Tift County Development Authority, et al by Hampton & Associates Surveying Co. dated January 13, 1997 and recorded in Plat Book 30 on page 131 in the Office of the Clerk of the Superior Court of Tift County, Georgia.

EXHIBIT 4.2

**SECOND AMENDED AND RESTATED  
CREDIT AND SECURITY AGREEMENT**

**Dated as of December 9, 2004**

**among**

**Delta Galil USA Inc., As Borrower,**

**Bank Leumi USA, As Agent**

**and**

**Each of the Persons which is a party hereto as a Bank**



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Exhibit A Form of Revolving Note  
Exhibit B Form of Notice of Advance  
Exhibit C Form of Term Note  
Exhibit D Form of Unlimited Guaranty  
Exhibit E Form of Security Agreement  
Exhibit F Form of Burlen Trademark Security Agreement  
Exhibit G Form of Amendment to Pledge Agreement  
Exhibit H Form of Confirmation of Guaranty and Security Agreement  
Exhibit I Form of Officer's Certificate  
Exhibit J Form of Borrowing Base Certificate

**THIS SECOND AMENDED AND RESTATED CREDIT AND SECURITY AGREEMENT** (this "Agreement") dated as of December 9, 2004 is among **DELTA GALIL USA Inc.**, a Delaware corporation having an office at 150 Meadowlands Parkway, Secaucus, New Jersey 07090 (the "Borrower"), **BANK LEUMI USA**, a New York banking corporation as agent for the Banks (the "Agent"), having an office at 564 Fifth Avenue, New York, New York 10036, and each of the Persons named in Schedule 1.1 annexed hereto (each a "Bank" and collectively, the "Banks").

As of September 11, 2000 Wundies Enterprises, Inc., Wundies Industries, Inc. (together, the "Original Borrowers"), Bank Leumi USA, Bank Hapoalim B.M. (together the "Original Lenders") and the Agent, entered into a Credit and Security Agreement (the "Original Agreement").

Pursuant to the Original Agreement, the Original Lenders (i) made a revolving loan commitment to make revolving loans to the Original Borrowers, in an aggregate principal amount, at any one time outstanding, not to exceed \$70,000,000, minus the principal amount of all outstanding letters of credit, (ii) made term loans and second term loans to the Original Borrowers in the aggregate initial principal amount of \$30,000,000, and (iii) made a facility available to the Original Borrowers for letters of credit, in an aggregate face amount, at any one time outstanding, not to exceed \$4,000,000.

Effective as of January 1, 2002, Wundies Enterprises, Inc. and its affiliate, Inner Secrets, Inc., merged with and into Wundies Industries, Inc. the surviving corporation (the "Merger"), which effective with the Merger, changed its name to Delta Galil USA Inc. Subsequently, the Original Agreement was amended, by agreements dated as June 14, 2002, September 25, 2002, May 1, 2003 and June 3, 2003 which amendments, among other things, provided that the Original Lenders would make third term loans to the Borrower and provide an acceptance facility to the Borrower.

As of June 30, 2004, the Original Agreement, as theretofor amended, was further amended and restated in an Amended and Restated Credit and Security Agreement (the "Restated Agreement") to provide, among other things, for (i) the Borrower's acquisition of Auburn, (ii) the inclusion of Auburn's eligible accounts and eligible inventory in the Borrowing Base, (iii) the guaranty by Auburn of the obligations, and (iv) security for Auburn's said guaranty.

The Agent, the Banks and the Borrower have agreed to further amend and restate the Restated Agreement, among other things, to (i) change the Maturity Date and (ii) make provision for (a) the Borrower's acquisition of Burlen, (b) the inclusion of Burlen's Eligible Accounts and Eligible Inventory in the Borrowing Base, (c) the Guaranty by Burlen of the Obligations, and (d) security for Burlen's said guaranty.

NOW, THEREFORE, it is agreed:



## ARTICLE 1

### DEFINITIONS

**Section 1.1** **General Definitions**. The terms defined herein include the plural as well as the singular, as the context may require. Except as otherwise indicated, all agreements defined herein refer to the same as they may from time to time be amended or supplemented or the terms thereof waived or modified in accordance herewith or therewith. When used herein, the following terms shall have the following meanings:

“Acceptance” and “Acceptances” shall have the meaning assigned to such terms in Section 2.12 of this Agreement.

“Acceptance Availability” shall have the meaning assigned to such term in Section 2.12.1 of this Agreement.

“Acceptance Documents” shall mean, with respect to any Acceptance, the Acceptance and the request therefore as provided in Section 2.12.2 hereof, and any other agreements, instruments, guarantees or other documents (whether general in application or applicable only to such Acceptance) governing or providing for (i) the rights and obligations of the parties concerned or at risk with respect to such Acceptance, or (ii) any collateral security for any such obligations, each as the same may be modified and supplemented and in effect from time to time.

“Account Debtor” shall mean the party who is obligated to any Loan Party under an Account.

“Accounts” shall have the meaning assigned to such term in the Uniform Commercial Code and in any event shall mean and include, all present and future rights of each of the Loan Parties, as is applicable, to payment for goods sold or leased or for services rendered, whether now existing or hereafter arising and wherever located, and whether or not they have been earned by performance including, without limitation, all Eligible Accounts (as herein defined), all obligations owing to any Loan Party arising out of or in connection with all guarantees and other security therefore, whether secured or unsecured, and all Indebtedness owed to the Borrower by its Affiliates.

“Advance” shall mean a Revolving Loan which the Borrower has requested that the Banks make pursuant to a Notice of Advance.

“Advance Date” shall have the meaning assigned to such term in Section 2.1 of this Agreement.

“Affiliate” shall mean, as to any Person, any Person that directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with, such Person. For purposes of this definition, control of a Person shall mean the power, direct or indirect, (i) to vote thirty (30%) percent or more of the securities having ordinary voting power for the election of directors of such Person, or (ii) to direct or cause the direction of the

management and policies of such Person whether by contract or otherwise.

“Agent” shall have the meaning set forth in the introduction to this Agreement, or any successor agent as is provided for in Section 11.8 of this Agreement.

“Agreement” shall mean this Second Amended and Restated Credit and Security Agreement, as same may be amended or restated from time to time.

“Auburn” shall mean Auburn Hosiery Mills, Inc., a Kentucky Corporation.

“Auburn Collateral” shall mean all property and interests in property now owned or hereafter acquired by Auburn in or upon which a Lien is granted to or created in favor of the Banks by Auburn to secure payment of the Obligations, pursuant to the Auburn Security Agreement.

“Auburn Security Agreement” shall mean the Security Agreement dated as of June 30, 2004 executed and delivered by Auburn pursuant to the Restated Agreement.

“Auburn Shares” shall mean all of the issued and outstanding shares of capital stock of Auburn.

“Bank” and “Banks” shall mean respectively each Person identified on Schedule 1.1 annexed, as same may be amended from time to time.

“Bank Commitment” shall mean the Commitment of each Bank and its Pro Rata Share of the Term Loan.

“Borrower” shall have the meaning set forth in the Introduction to this Agreement.

“Borrowing Base” shall mean, as of any date of determination, an amount equal to the sum of (i) eighty-five (85%) percent of the Eligible Accounts; plus (ii) during the period (a) October 1 through February 28, the lesser of (1) \$36,000,000 or (2) fifty-five (55%) percent of the value of Eligible Inventory, and (b) during the period March 1 through September 30 of each year, the lesser of (1) \$42,000,000 or (2) sixty-five (65%) percent of the Eligible Inventory; which sum (the total of (i) and (ii)) shall be reduced by the amount, if any, by which the sum of the Eligible Accounts of Auburn plus the Eligible Inventory of Auburn exceeds the lesser of (a) \$10,000,000, or (b) the amount of all outstanding debt owing by Auburn to the Borrower. For the purposes of determining the Borrowing Base, Eligible Inventory shall (I) be valued at the lower of cost or market, (II) include only the lesser of (a) fifty-five (55%) percent or sixty-five (65%) percent, as is applicable, of the Eligible Inventory of Auburn consisting of “Wilson Sports Socks” or (b) Inventory of “Wilson Sports Socks” valued at \$4,000,000, and (III) fifty-five (55%) percent or sixty-five (65%) percent, as applicable, of the Eligible Inventory of Auburn consisting of Converse, Inc. licensed products may be limited as is provided in Section 7.7.3 of this Agreement.

“Burlen” shall mean Burlen Corp., a Georgia corporation.

“Burlen Collateral” shall mean all property and interests in property now owned or hereafter acquired by Burlen in or upon which a Lien is granted to or created in favor of the Banks by Burlen to secure payment of the Obligations, pursuant to the Security Agreement provided for in Section 3.1.4 of this Agreement.

“Burlen Judgment Lien” shall mean the judgment lien against Burlen arising out of a preference claim in the approximate amount of \$20,000.

“Burlen Security Agreement” shall have the meaning defined in Section 3.1.4 of this Agreement.

“Burlen Shares” shall mean all of the issued and outstanding shares of capital stock of Burlen.

“Business Day” shall mean, any day on which commercial banks in both New York, New York and Israel are required by law to be open for business.

“Capitalized Lease Obligations” shall mean all obligations of a lessee which, in accordance with GAAP, should be capitalized on the books of such lessee.

“Closing Date” shall mean the date on which all conditions to be met, as provided in Section 3.1, shall have been satisfied.

“Collateral” shall mean, all property and interests in property now owned or hereafter acquired by the Borrower in or upon which a Lien is granted to or created in favor of the Banks by the Borrower to secure payment of the Obligations, whether under Article 5 or any other provision of this Agreement, under any of the other Loan Documents, or under any other documents, instruments or writings executed by or on behalf of the Borrower and delivered to the Agent or any of the Banks.

“Commitment” shall mean each Bank’s obligation to make Revolving Loans, and its obligations with respect to Letters of Credit and Acceptances.

“Default” shall mean the occurrence of any event or circumstance which, with the giving of notice or lapse of time, or both, would constitute an Event of Default.

“Delta Galil” shall mean, Delta Galil Industries Ltd., an Israeli corporation.

“Delta Galil Guarantees” shall have the meaning assigned to such term in Section 3.1.9 of this Agreement.

“EBITDA” shall mean, with respect to any period, the net income of the Loan Parties, on a consolidated basis, after taxes for such period (excluding any after-tax gains or losses on the sale of assets (other than the sale of Inventory in the ordinary course of business) and excluding other after-tax extraordinary gains or losses) plus interest expense, income tax expense,

depreciation and amortization for such period, plus or minus any other non-cash charges or gains which have been subtracted or added in calculating net income after taxes for such period, for all of the Loan Parties, on a consolidated basis. For the purposes of the calculation of EBITDA hereunder, as of June 30, 2005, the EBITDA generated by Burlen for the period from June 30, 2004 through December 31, 2004 will be added. In addition, for the purposes of calculating EBITDA hereunder as of September 30, 2004, the EBITDA of Burlen for the period from September 30, 2004 through December 31, 2004 will be added.

“Eligible Accounts” shall mean Accounts which consist of ordinary trade accounts receivable owned by any of the Loan Parties payable in cash in United States dollars and arising out of the final sale of Eligible Inventory in the ordinary course of a Loan Party's business as presently conducted other than: (i) any Account with respect to which the goods covered thereby have not been delivered or with respect to which such Loan Party failed to issue an original invoice within two (2) days after delivery of such goods; (ii) any Account with respect to which the Banks do not have a valid perfected Lien (iii) any Account which is subject to Liens or other claims of another Person (other than the Permitted Encumbrances) (iv) any Account which is not due and payable, absolutely and unconditionally, within one hundred twenty (120) days from the date of the original invoice; (v) any Account which is not paid within sixty (60) days from its due date; (vi) unless otherwise provided in the next subsection or as agreed by the Agent, so much of the Accounts of an Account Debtor as exceed ten (10%) percent of the Eligible Accounts; (vii) so much of the Accounts of (A) each of Walmart, Inc. and Sam's Club division of Walmart, Inc. as exceed forty-five (45%) percent of the Eligible Accounts; provided that all such Eligible Accounts do not exceed seventy (70%) percent of the Eligible Accounts, (B) Target Stores, Inc. as exceed forty-five (45%) percent of the Eligible Accounts, (C) J.C. Penny, Inc. as exceed thirty-five (35%) percent of the Eligible Accounts, and (D) K-Mart, Inc. and/or Sears Roebuck & Co., Inc. and/or Lands End, Inc. as exceed the lesser of \$10,000,000, or thirty-five (35%) percent of the Eligible Accounts, (viii) any Account resulting from goods which are shipped or delivered to the Account Debtor on an absolute sale basis or goods shipped on a bill and hold sale basis, a consignment sale basis, a guaranteed sale basis, a sale or return basis, or on the basis of any other similar understanding; (ix) any Account with respect to which the Account Debtor is an Affiliate of the Borrower; (x) any Account with respect to which the Account Debtor is the United States of America or any department, agency or instrumentality thereof; (xi) any Account with respect to which the Account Debtor is not a United States Person or is not located in the United States, unless the sale is on letter of credit or acceptance terms; (xii) any Account with respect to which the Account Debtor is the subject of bankruptcy or a similar insolvency proceeding, or has made an assignment for the benefit of creditors, or whose assets have been conveyed to a receiver or trustee, or who has failed or suspended or gone out of business; (xiii) any Account which is evidenced by chattel paper, a promissory note or other instrument; (xiv) any Account with respect to which the terms or conditions prohibit or restrict assignment or collection rights; (xv) any Account which does not conform at the time to the Borrower's representations and warranties; and (xvi) any Account for which the prospect of payment is or will be impaired, in the reasonable determination of the Agent.

“Eligible Inventory” shall mean all Inventory, other than work-in-progress, which is part of a Loan Party's current line of goods and not seconds or returns, and in which the Agent, as agent for the Banks a valid Lien perfected within the United States (subject to the next sentence),

and which is free of all Liens or claims of other Persons (other than Permitted Encumbrances) and which is not, in the Agent's opinion, unmerchantable, and which the Agent in its sole judgment, shall deem Eligible Inventory based on such considerations as the Banks may from time to time give the Agent by notice. Eligible Inventory shall include finished goods in-transit for which title has passed to a Loan Party, provided same are insured to the full value thereof, or (i) in the case of an Issuer, having issued a Letter of Credit, for which the Agent shall have in its possession all negotiable bills of lading properly endorsed and all non-negotiable bills of lading issued in the Agent's or any Bank's name; and (ii) in the case of payment being made by sight draft, such bills of lading shall be held by the Agent or any Bank; provided, however, that in each case such bills of lading shall be delivered to the applicable Loan Party, in the ordinary course of business, in connection with the clearance of such Inventory through the United States customs.

“Environment” means any surface or subsurface water, water vapor, surface or subsurface land, soil, sand, gravel, stone, rock, air, fish, wildlife, animal life, vegetation, micro-organisms and all other natural resources.

“Environmental Complaint” shall have the meaning set forth in Section 6.19 of this Agreement.

“Environmental Law” shall mean any law, ordinance, rule, regulation or requirement, issued by any federal, foreign, state or local governmental or quasi-governmental authority, whether now existing or hereinafter enacted, and any judicial or administrative interpretations thereof, regulating the disposal, distribution generation, handling, manufacture, possession, processing, production, sale, storage, transport, treatment or use of any Hazardous Substance or relating to the protection of the Environment, including, without limitation, any health or safety laws directly related to the protection of the Environment.

“Environmental Permits” shall mean all permits, licenses, certificates, approvals, authorizations, consents or registrations required by any applicable Environmental Law in connection with the ownership, use and/or operation of the Premises, including without limitation those required for the disposal, distribution, generation, handling, manufacture, possession, processing, production, sale, storage, treatment, transport or use of any Hazardous Substance.

“Equipment” shall have the meaning set forth in the Uniform Commercial Code and in any event shall mean and include all machinery, all manufacturing, distribution, selling, data processing, office and other equipment, all furniture, fixtures, trade fixtures, tools, tooling, molds, dies and vehicles, and all other goods other than Inventory, and in each case whether now owned or hereafter acquired by a Loan Party wherever located, and accessions and additions thereto, parts and appurtenances thereof, substitutions therefor and replacements thereof.

“ERISA” shall mean the Employee Retirement Income Security Act of 1974, as amended.

“Eurocurrency Liabilities” shall have the meaning specified in Regulation D of the Board

of Governors of the Federal Reserve System, as in effect from time to time.

“Event of Default” shall have the meaning set forth in Section 9.1 of this Agreement.

“Federal Reserve Board” shall mean the Board of Governors of the Federal Reserve System or its successor.

“Financial Statements” shall have the meaning set forth in Section 6.13 of this Agreement.

“Fixed Charges” shall mean for any period, without duplication, scheduled payments of principal during the applicable period with respect to all Indebtedness of the Borrower, on a consolidated basis with the other Loan Parties, for borrowed money, plus scheduled payments of the principal during the applicable period with respect to all Capitalized Lease Obligations of the Borrower, on a consolidated basis with the other Loan Parties, plus scheduled payments of interest during the applicable period with respect to all Indebtedness of the Borrower, on a consolidated basis with the other Loan Parties, for borrowed money including Capitalized Lease Obligations, plus unfinanced capital expenditures of the Borrower, on a consolidated basis with the other Loan Parties, during the applicable period, plus payments during the applicable period in respect of income or franchise taxes of the Borrower, on a consolidated basis with the other Loan Parties.

“GAAP” shall mean generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as may be approved by a significant segment of the accounting profession which are applicable to the circumstances as of the date of determination.

“General Intangibles” shall have the meaning set forth in the Uniform Commercial Code, and in any event shall mean and include all rights, interests, choses in action, causes of action and all other intangible personal property of the Loan Parties of every kind and nature (other than Accounts), now owned or hereafter acquired by any Loan Party, including, without limitation, corporate or other business records, loans and other obligations receivable, inventions, designs, patents, patent applications, provisional patent applications, manufacturing processes and procedures, proprietary technical information, quality control procedures, confidential business information, know-how, copyright applications, computer programs and software, service marks, trademarks, trade names, trade secrets, goodwill, registrations, copyrights, license rights, franchises, customer lists, customer and supplier contracts, firm sale orders, partnerships and joint ventures, other contracts and contract rights, tax refunds and tax refund claims, deposit accounts (general or special) with, and all credits and claims against, any financial institution, rights and claims against carriers and shippers, rights to indemnification, rights to proceeds of insurance of which a Loan Party is beneficiary, and any letter of credit, guaranty or Liens held by or granted to any Loan Party to secure payment of any obligation owing by any Person to any Loan Party, and the like, however and wherever arising.

“Georgia Properties” means the premises located at (i) 1904 McCormick Drive, Tifton, Georgia, and (ii) 26 Forstmann Drive, Tifton, Georgia.

“Georgia Real Estate Documentation” shall have the meaning set forth in Section 3.2.1 of this Agreement.

“Guarantor” and “Guarantors” mean respectively (i) each of Auburn, Burlen, and Delta Galil, and (ii) all of Auburn, Burlen, Delta Galil, and any new subsidiary of the Borrower, Auburn or Burlen (as permitted in Section 8.13 of this Agreement) that does not become a Borrower as is provided therein.

“Hazardous Substance” shall mean any material whatsoever, which is or may potentially be harmful to the Environment, or to the health or safety of human or animal life or vegetation, regardless of whether such material be found on or below the surface of the ground, in any surface or underground water, airborne in ambient air or in the air inside of any structure built or located upon or below the surface of the ground, or in any machinery, equipment or inventory located or used in any such structure, including but not limited to all hazardous substances, hazardous materials, hazardous wastes, toxic substances, infectious wastes, medical wastes, imminently hazardous substances, pollutants and contaminants from time to time defined, listed, identified, designated, or classified as such under any Environmental Law regardless of the quantity of any such material.

“Honduras Shares” means the shares of capital stock of Wundies de Honduras.

“Improvements” shall have the meaning set forth in Section 6.20.1 of this Agreement.

“Indebtedness” shall mean with respect to any specified Person, (i) all indebtedness of such Person for borrowed money (including, without limitation, reimbursement and all other obligations with respect to surety bonds, letters of credit and bankers' acceptances, whether or not matured) or for the deferred purchase price of property or services, (ii) all obligations of such Person evidenced by notes, bonds, debentures or similar instruments, (iii) all indebtedness of such Person created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person (even though the rights and remedies under such agreement in the event of default are limited to repossession on sale of any such property), (iv) all Capitalized Lease Obligations of such Person, (v) all contingent obligations, (vi) all indebtedness referred to in clause (i), (ii), (iii), (iv) or (v) above secured by (or for which the holder of such indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien upon or in property (including, without limitation, accounts and contracts rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such indebtedness, and (vii) the Obligations.

“Interest Charges” shall mean, for any period, the total interest expense of the Borrower during such period with respect to all Indebtedness determined in accordance with GAAP (including the interest component of lease payments), provided, however, that such term shall not include any amortization of deferred financing charges that might be included in interest expense in accordance with GAAP.

“Interest Period” shall mean with respect to (i) any LIBOR Rate Loan (A) initially, the period commencing on the Advance Date with respect to such LIBOR Rate Loan and ending one (1), two (2) or three (3) months thereafter (or such other period as shall be agreed to by the Agent, but in no event shall such period be greater than eleven (11) months), as selected by the Borrower in its Notice of Advance, given with respect thereto; and (B) thereafter, each period commencing on the last day of the next preceding Interest Period applicable to such LIBOR Rate Loan, and ending one (1), two (2) or three (3) months thereafter (or such other period as shall be agreed to by the Agent, but in no event shall such period be greater than eleven (11) months), as selected by the Borrower by a notice of continuation with respect thereto (or if no notice of continuation is given, the Interest Period shall be the same as the prior Interest Period); and (ii) the Term Loan, each period commencing on the last day of the next preceding Interest Period applicable to the Term Loan and ending three (3) months thereafter. All of the foregoing provisions relating to Interest Periods are subject to the following: (i) if any Interest Period would otherwise end on a day that is not a LIBOR Business Day, such Interest Period shall be extended to the next succeeding LIBOR Business Day unless the result of such extension would be to carry such Interest Period into another calendar month in which event such Interest Period shall end on the immediately preceding LIBOR Business Day; (ii) if any Interest Period would otherwise extend beyond (x) the Maturity Date in the case of a LIBOR Rate Loan, it shall end on the Maturity Date or (y) December 1, 2009 in the case of the Term Loan, it shall end on December 1, 2009; (iii) any Interest Period that begins on the last LIBOR Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such Interest Period) shall end on the last Business Day of a calendar month; and (iv) the Borrower shall select Interest Periods so as not to require a payment or prepayment of any LIBOR Rate Loan as the case may be, during an Interest Period applicable thereto.

“Internal Revenue Code” shall mean the Internal Revenue Code of 1986, as amended.

“Inventory” shall have the meaning set forth in the Uniform Commercial Code and in any event shall mean and include all goods, merchandise and other personal property now owned or hereafter acquired by any Loan Party (wherever located, whether in the possession of a Loan Party or of a bailee or other Person) which are held to be furnished under any contract of service or for sale or other disposition, all raw materials, work in process, supplies, whole goods, spare parts and components, materials and supplies of any kind which are or might be used or consumed in a Loan Party's business or used in connection with the manufacture, packing, shipping, advertising, selling or finishing of any such goods, all documents of title representing the same, and all records, files and writings with respect thereto, and shall include such property the sale or other disposition of which has given rise to Accounts and which has been returned to or repossessed or stopped in transit by a Loan Party.

“Issuer” shall mean any Bank which issues a Letter of Credit and/or accepts a draft pursuant to the terms hereof.

“Leases” shall mean the leases pursuant to which the premises located at (i) 3607 West Fourth Street, Williamsport, Pennsylvania, and (ii) 150 Meadowlands Parkway, Secaucus, New Jersey have been demised to the Borrower.



“Letter of Credit” shall have the meaning set forth in Section 2.11.1 of this Agreement.

“LIBOR Business Day” shall mean any day on which the Banks are open for business in New York City and on which commercial banks in the City of London, England are open for dealings in U.S. dollar deposits in the London Interbank Market.

“LIBOR Rate” shall mean relative to any Interest Period, the rate (rounded to the next higher 1/16th of 1%) for U.S. dollar deposits of the maturity corresponding to the Interest Period, as quoted by the British Bankers Association in London as its “LIBOR” rate for U.S. dollar deposits as of 11:00 a.m. London time, on the second LIBOR Business Day before the relevant Interest Period begins; provided, however, that if the Agent adopts generally in its business a different rate quoting system or service for obtaining the rate of interest commonly known as “LIBOR” for U.S. dollar deposits, then upon giving prompt notice to the Borrower such alternative rate quoting system or service shall be utilized for determining “LIBOR” in lieu of the rate quoted by the British Bankers Association.

“LIBOR Rate Loan” shall mean a Revolving Loan on which interest shall be charged at the Revolving LIBOR Loan Rate.

“Lien” shall mean a security interest, collateral assignment, deed of trust or mortgage or assignment or any other encumbrance upon or charge against or interest in property to secure payment of a debt or performance of an obligation, including, but not limited to, the retained or security title of a conditional vendor or of a lessor under a Capitalized Lease Obligation, on assignment of a right to receive income or a sale or other transfer of an Account, chattel paper or General Intangible.

“Loan” and “Loans” shall mean, respectively, (i) any Revolving Loan and the Term Loan, and (ii) all of the foregoing.

“Loan Documents” shall mean, this Agreement, the Revolving Note, the Term Note, the Pledge Agreement, the Real Estate Collateralization Documents, the Security Agreements, the Trademark Security Agreements, the guarantees and any other agreements executed and delivered by each Guarantor, and all other agreements, instruments and documents, including, without limitation, security agreements, loan agreements, notes, mortgages, deeds of trust, intercreditor agreements, assignment of leases, pledges, powers of attorney, consents, assignments, collateral assignments, letter agreements, contracts, notices, financing statements, account opening documents, and all other writings, all of which must be in form and substance satisfactory to the Agent, heretofore, now, or hereafter executed by or on behalf of the Borrower or any Guarantor and delivered to the Agent or any Bank pursuant to or in furtherance of this Agreement, together with all agreements, instruments and documents referred to therein or contemplated thereby and as now in effect or as at any time amended, modified or changed.

“Loan Party” and “Loan Parties” shall mean respectively (i) each of the Borrower, Auburn and Burlen, and (ii) all of the Borrower, Auburn and Burlen.

“Material Adverse Effect” shall mean the results of one or more circumstances or events, financial or otherwise, which individually or in the aggregate would have a material adverse effect on the financial condition, results of operations or business of any Loan Party or Guarantor in the sole discretion of the Banks and with respect to which the Banks have given the Borrower notice.

“Maturity Date” shall mean the earliest of (i) January 15, 2006, and (ii) the date of an acceleration pursuant to Section 10.1 of this Agreement.

“Merger” shall have the meaning set forth in the Introduction to this Agreement.

“Multiemployer Plan” shall mean a Plan described in Section 4001(a)(3) of ERISA.

“Net Worth” shall mean with respect to any specified Person, as at any date of determination, the Total Assets of such Person including, without limitation, goodwill, franchises, licenses, patents, trademarks, trade names, copyrights, service marks and brand names, after subtracting therefrom all amounts due from Affiliates and employees of such Person, minus Total Liabilities of such Person (excluding any debt fully subordinated to the Obligations on written terms satisfactory to the Banks), in each case determined in accordance with GAAP.

“Notes” shall mean the Revolving Note and the Term Note.

“Notice of Advance” shall have the meaning set forth in Section 2.2 of this Agreement.

“Obligations” shall mean, all present and future Indebtedness and other liabilities and obligations of any Loan Party, to the Agent, any Bank or an Affiliate of any Bank of every type and description, at any time arising under or with respect to this Agreement or any of the other Loan Documents or the transactions contemplated hereby or thereby or any other extension of credit or transaction of any type or nature, whether or not presently contemplated, that is made or entered into by a Bank or any Affiliate of a Bank in connection with this Agreement, including all overdrafts of the Borrower.

“Outstanding Revolving Loan Balance” shall mean the amount of all Obligations in connection with the Revolving Loans outstanding at any given time and pursuant to this Agreement, but excluding any interest, fees or charges not yet due.

“PBGC” means the Pension Benefit Guaranty Corporation or any entity succeeding to any or all of its functions under ERISA.

“Permitted Encumbrances” shall mean as to any property and assets of any Loan Party (i) liens incurred or deposits made in the ordinary course of business in connection with governmental requirements respecting workmen's compensation, unemployment insurance, social security and other like laws, (ii) Liens for taxes, assessments or other governmental charges not delinquent, or being contested in good faith and by appropriate proceedings and with respect to which proper reserves have been taken by the applicable Loan Party; provided,

however, that no enforcement of such Lien shall be occurring or a stay of enforcement of any such Lien shall be in effect; (iii) Liens disclosed in the consolidated financial statements of the Borrower, the existence of which the Required Lenders have specifically consented to in writing; (iv) easements, rights of way and other encumbrances on title to real property; (v) deposits or pledges to secure bids, tenders, contracts (other than contracts for the payment of money), leases, statutory obligations, surety and appeal bonds and other obligations of like nature arising in the ordinary course of a Loan Party's business not to exceed \$250,000 in the aggregate; (vi) judgment Liens that have been stayed or bonded, the Burlen Judgment Lien and mechanics', workers', materialmen's or other like Liens arising in the ordinary course of a Loan Party's business with respect to obligations that are not over-due for a period of more than thirty (30) days or that are being contested in good faith by a Loan Party, with appropriate reserves set aside, such amount of reserves to be established by the Agent in its commercially reasonable discretion and with respect to Liens in excess of \$250,000 if in effect for more than thirty (30) days, fully bonded; (vii) Liens placed upon fixed assets hereafter acquired to secure a portion of the purchase price thereof, provided, however, that any such Lien shall not encumber any other property of a Loan Party and (viii) Liens securing the Obligations as provided in this Agreement and the other Loan Documents. In addition, Permitted Encumbrances shall also mean as to the Leases (i) the interest or title of a lessor or sublessor under any Lease, (ii) a restriction or encumbrance that the interest of title of such lessor or sublessor may be subject to (including without limitation, a ground lease or other prior lease of the demised premises, mortgages, mechanics liens, tax liens and easements), or (iii) subordination of the interest of the lessee or sublessee under such Lease to any restrictions or encumbrance referred to in the preceding sub-clause (ii).

“Person” shall mean any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, limited liability company, institution, entity, party or government, including, without limitation, any instrumentality, division, agency, body or department thereof.

“Plan” shall mean any “employee pension benefit plan” as defined in Section 3(2) of ERISA maintained by the Borrower or any Affiliate of the Borrower or to which the Borrower or an Affiliate of the Borrower is required to contribute.

“Pledge Agreement” shall mean that certain Pledge Agreement dated as of September 11, 2000 between the Agent and Wundies Enterprises, Inc., as amended.

“Premises” shall mean the land surface and the entire subsurface, all surface water and subsurface water, whether flowing or stagnant, the ambient air, all structures, fixtures and buildings located, situated or erected on the land, and all machinery and equipment located at or in connection with any such structure, now or subsequently used, occupied, possessed, owned, operated or managed by any Loan Party or its Affiliates, including the Real Estate Assets.

“Prime Rate” shall mean a fluctuating interest rate per annum which shall at all times be equal to the rate of interest announced in New York, New York, from time to time, as the prime rate of the Agent acting as a Bank (which such Bank may refer to as its “reference rate”, “base rate”, or by some other reference) which is not necessarily the lowest or best rate charged to

creditworthy customers.

“Prime Rate Loan” shall mean a Revolving Loan on which interest shall be charged at the Prime Rate.

“Pro Rata Share” shall mean with respect to each Bank, as at any date same is to be determined, the percent shown on Schedule 1.1 annexed hereto; unless there is an assignment by a Bank of a portion of its Commitment in which event each Bank’s Pro Rata Share shall be as set forth in the Register provided for in Section 12.14.5 of this Agreement.

“Real Estate Assets” shall mean (i) the Borrower’s fee title estate in and to premises (a) RR3 Shumway Hill Road, Wellsboro, Pennsylvania, (b) 1501 West Third Street, Williamsport, Pennsylvania, and (c) 395 Ledbetter Road, Rockingham, North Carolina, (ii) the Borrower’s leasehold estate in and to the premises demised under the Leases, (iii) Auburn’s fee title estate in and to premises 502 West Gallatin Street, Adairsville, Kentucky, and in and to premises 113 East Main Street, Auburn, Kentucky, and (iv) Burlen’s fee title estate in and to the Georgia Properties.

“Real Estate Collateralization Documentation” shall mean the mortgages and deeds of trust, assignments and/or UCC-1 Financing Statements and other documents relating to the Real Estate Assets executed and delivered pursuant to the Original Agreement, the June 14, 2002 Amendment thereto, and pursuant to this Agreement.

“Release” shall mean any discharging, disposing, emitting, leaking, pumping, pouring, emptying, injecting, escaping, leaching, dumping or spilling of any Hazardous Substance into the Environment (including without limitation the abandonment or discarding of barrels, containers, and other closed receptacles).

“Required Lenders” shall mean, as at any date at which the same is to be determined, Banks having, in the aggregate, a Pro Rata Share which is more than sixty seven (67%) percent.

“Revolving Facility Amount” shall mean at any time at which same is to be determined, the lesser of (i) the Borrowing Base, or (ii) \$60,000,000; in either case minus the face amount of all Letters of Credit and Acceptances then outstanding.

“Revolving LIBOR Loan Rate” shall mean the LIBOR Rate plus one and fifteen one hundredth (1.15%) percent.

“Revolving Loan” shall have the meaning set forth in Section 2.1 of this Agreement.

“Revolving Loan Commitment” shall mean the sum of \$60,000,000.

“Revolving Note” shall have the meaning set forth in Section 2.1 of this Agreement.

“Roll Over Date” applicable to a particular Interest Period shall mean the last day of such Interest Period.

"Security Agreement" and "Security Agreements" shall mean respectively (i) each of the Auburn Security Agreement and the Burlen Security Agreement, and (ii) both the Auburn Security Agreement and Burlen Security Agreement.

"Term Loan" shall have the meaning set forth in Section 2.4.2 of this Agreement.

"Term Loan Rate" shall mean the LIBOR Rate plus one and four tenths (1.40%) percent.

"Term Note" shall have the meaning set forth in Section 2.4.2 of this Agreement.

"Total Assets" shall mean all assets, including intangible assets (if owned on the date hereof, valued as provided in the Borrower's most recent Financial Statement, and if acquired after the date hereof, valued at cost) appearing on the assets side of the balance sheet, in accordance with GAAP.

"Total Liabilities" shall mean all liabilities, including capitalized leases and all reserves for deferred taxes and other deferred sums appearing on the liabilities side of the balance sheet, in accordance with GAAP.

"Trademark Security Agreements" shall mean the Amended and Restated Trademark Security Agreement made by the Borrower and the Trademark Security Agreement made by Auburn, each dated as of June 30, 2004, and the Trademark Security Agreement made by Burlen, as provided in Section 3.1.4 of this Agreement.

"Uniform Commercial Code" shall have the meaning set forth in Section 1.3 of this Agreement.

"Wundies de Honduras" shall mean Wundies de Honduras S.A. de C.V., a Honduras corporation.

**Section 1.2 Accounting Terms.** Any accounting terms used in this Agreement which are not specifically defined herein shall have the meanings customarily given them in accordance with GAAP.

**Section 1.3 Terms Defined in Uniform Commercial Code.** All other terms contained in this Agreement (and which are not otherwise specifically defined herein) shall have the meanings provided by the Uniform Commercial Code of the State of New York (the "Uniform Commercial Code") in effect as of the Closing Date to the extent the same are used or defined therein, and all references to the Uniform Commercial Code shall mean the Uniform Commercial Code as in effect on the Closing Date.

## ARTICLE 2

### CREDIT FACILITY

**Section 2.1 Revolving Loan Facility.** Subject to the terms and conditions of this Agreement, each of the Banks, severally and not jointly, shall make revolving loans available to the Borrower in the following manner. During the period from the date hereof to and including such date as is thirty (30) days prior to the Maturity Date, each Bank will make revolving loans (each a “Revolving Loan” and collectively the “Revolving Loans”) to the Borrower in amounts not to exceed such Banks’ Pro Rata Share which, when added to the then Outstanding Revolving Loan Balance, do not exceed the then effective Revolving Facility Amount. The date a Revolving Loan is made is referred to as the “Advance Date”. The Borrower may borrow, repay and reborrow the Revolving Loans subject to the terms of this Agreement. The Borrower’s Obligations with respect to each Advance shall be outstanding, due and enforceable in accordance with the terms of the third amended and restated revolving note, duly executed by the Borrower, dated as of the Closing Date, substantially in the form annexed hereto as Exhibit “A” (the “Revolving Note”) delivered and payable to the Agent as agent for the Banks in the principal amount of \$60,000,000. The Revolving Note amends, restates and replaces the two (2) outstanding second amended and restated revolving notes made by the Borrower, one to the order of each Original Lender each of which is hereby cancelled, but the Revolving Note does not extinguish or negate the debt evidenced thereby. Each Bank shall fund each Revolving Loan through the Agent as provided herein. The Agent on behalf of each Bank, shall, and is hereby authorized by the Borrower to, endorse on the schedule attached to the Revolving Note (or on a continuation of such schedule attached to the Revolving Note and made a part thereof) or in the Agent’s books and records evidencing such Revolving Loan, an appropriate notation evidencing the date and amount of each Revolving Loan to the Borrower (including all Revolving Loans outstanding as of the Closing Date) as well as the date and amount of each payment and prepayment with respect thereto; provided, however, that the failure of the Agent to make such a notation on a Revolving Note shall not affect any Obligations of the Borrower under the Revolving Note. Any such notation shall be presumptively correct as to the date and amount of the Revolving Loan or portion thereof, or payment or prepayment of principal or interest thereon, absent manifest error.

**Section 2.2 Making the Revolving Loans.** Each Revolving Loan shall be made on notice (a “Notice of Advance”), given by the Borrower to the Agent and the Banks not later than 11:00 A.M. (New York City time) on the third Business Day prior to the date of the proposed Revolving Loan, if it is to be a LIBOR Rate Loan, or one (1) Business Day prior to the date of the proposed Revolving Loan if it is to be a Prime Rate Loan. Each Notice of Advance shall be in the form of “Exhibit B” annexed hereto. Each Notice of Advance shall specify therein (i) the date of such proposed Advance, (ii) the aggregate amount of such proposed Advance, (iii) whether the Advance is to be a Prime Rate Loan or LIBOR Rate Loan, and (iv) if the Revolving Loan is to be a LIBOR Rate Loan, the initial Interest Period for such Advance. Each Notice of Advance shall be irrevocable and binding on the Borrower. The Agent on the same day it receives a Notice of Advance shall advise each Bank of such Bank's Pro Rata Share of the requested Advance (such Bank's Revolving Loan). The Borrower shall indemnify the Agent and each Bank against any loss, cost or expense incurred by any of them as a result of any failure of

the Borrower to fulfill, on or before the date specified in such Notice of Advance for such proposed Advance, the applicable conditions set forth in Article III, including, without limitation, any loss (including loss of anticipated profits), cost or expense incurred by reason of the liquidation or reemployment of deposits or other funds acquired by any Bank to fund any Revolving Loan to be made by such Bank as part of such proposed Advance. Each Revolving Loan shall be in a minimum aggregate principal amount of \$1,000,000 or in integral multiples of \$100,000 in excess thereof. The Borrower may not give more than five (5) Notices of Advance in any one month. All Revolving Loans comprising the same borrowing shall be made by each Bank simultaneously and proportionately to their respective Pro Rata Shares, it being understood that no Bank shall be responsible for any failure by any other Bank to perform its obligation to make a Revolving Loan hereunder, nor shall the commitment of any Bank be increased or decreased as a result of any such failure. If any Bank fails to perform its obligation to make a Revolving Loan, the Borrower shall be given notice thereof. Each Bank shall make its Revolving Loan on the proposed date thereof by paying the amount required to the Agent in New York, New York in immediately available funds not later than noon, New York City time, and the Agent shall as soon as practicable, but in no event later than noon, New York City time on the proposed date thereof, credit the amounts so received to the general deposit account of the Borrower with the Agent in immediately available funds or, if the Revolving Loans are not to be made on such date because any condition precedent to a borrowing herein specified is not met, promptly return the amounts so received to the respective Banks.

### **Section 2.3**    **Revolving Loan Payments.**

2.3.1 **Payments.** The aggregate unpaid principal amount of the Revolving Loans shall be due and payable in full, without notice or demand to the Borrower on the Maturity Date and shall be payable to the Agent in immediately available funds without offset or counterclaim. The Borrower hereby authorizes the Agent to charge any of its accounts with the Agent for any amount due and payable. Absent the occurrence of an Event of Default all payments shall be applied first to fees and expenses, than to interest on the Obligations, and the balance to principal in accordance with this Agreement. Whenever any payment due hereunder, or under any other Loan Document, shall be stated to be due on a day other than a Business Day, such payment shall be made on the next succeeding Business Day, and such extension of time shall in such case be included in the computation of payment of interest. Upon receipt of payment from the Borrower, of principal or interest, the Agent shall pay each Bank its Pro Rata Share on the same day as the Borrower's said payment if such payment is received by the Agent before 2:00 p.m., and otherwise on the next Business Day (which for the purposes of this Section shall mean any day on which commercial banks are open for business in New York, New York). If any payment from the Borrower is received after 2 p.m., the Borrower shall be responsible for interest until the next Business Day.

2.3.2 **Mandatory Payments of Revolving Loans.** If at any time the Outstanding Revolving Loan Balance shall exceed the Revolving Facility Amount, the Borrower, without demand or notice, shall immediately pay to the Agent such amount as may be necessary to eliminate such excess, and the Agent shall pay each Bank its Pro Rata Share thereof, as is provided in Section 2.3.1 of this Agreement.

## **Section 2.4 The Term Loan**

2.4.1 Outstanding Term Loans. On September 11, 2000, each Original Lender made a term loan to the Original Borrowers in the principal amount of \$5,000,000. The Original Borrowers evidenced their obligation to pay the interest and principal on each term loan by executing and delivering two (2) term notes, one (1) payable to each Original Lender, each dated as of September 11, 2000, and in the principal amount of \$5,000,000 which notes were amended and restated as of June 14, 2002. On January 5, 2001 each Original Lender made a second term loan to the Original Borrowers in the principal amount of \$10,000,000. The Original Borrowers evidenced their obligation to pay the principal of and interest on each second term loan by executing and delivering two (2) term notes, one (1) payable to each Original Lender, each dated as of January 5, 2001 and in the principal amount of \$10,000,000, which notes were amended and restated as of June 14, 2002. On June 14, 2002 each Original Lender made a third term loan to the Borrower in the principal amount of \$2,500,000. The Borrower evidenced its obligation to pay the principal of and interest on each third term loan by executing and delivering two (2) term notes, one (1) payable to each Original Lender, each dated as of the June 14, 2002, and in the principal amount of \$2,500,000. The Borrower hereby confirms that (i) the aggregate principal balance of the term loans made to the Original Borrowers and to it by the Original Lenders, as of the Closing Date is \$7,428,600, (ii) each note evidencing the said term loans is its valid and binding agreement, and (iii) it has no defense, claim, or offset to payment of any of the said term loans.

2.4.2 New Term Loan and Consolidation. Concurrently with the execution and delivery of this Agreement, the Banks through the Agent, are making an additional term loan to the Borrower in the principal amount of \$62,571,400, to which amount is being added the aggregate principal balance of the term loans made by the Original Lenders to the Original Borrowers and to the Borrower, as described in Section 2.4.1 hereof. Accordingly, the principal amount of the term loan as of the Closing Date is \$70,000,000 (the "Term Loan"). The principal amount of the Term Loan shall be repaid by the Borrower to the Agent, as agent for the Banks, in twenty (20) consecutive quarterly installments due and payable on the first day of each March, June, September and December commencing March 2005. Each such installment shall be in the principal amount of \$3,500,000. Concurrently the Borrower is evidencing its obligation to pay the principal or interest on the Term Loan by executing and delivering a term note dated as of even date herewith in the principal amount of \$70,000,000 substantially in the form of the term note annexed hereto as Exhibit C (the "Term Note"). The Term Note incorporates and amends, restates and replaces each of the term notes referred to in Section 2.4.1 of this Agreement, each of which is hereby cancelled, but the Term Note which in no way extinguishes or negates the Obligations evidenced thereby. If any payment from the Borrower is received after 2 p.m., the Borrower shall be responsible for interest until the next Business Day.

2.4.3 Payments. Absent the occurrence of an Event of Default, all payments shall be applied first to fees and expenses, then to interest on the Obligations, and the balance to principal in accordance with this Agreement. The Borrower shall make all payments of principal and interest on the Term Loan in immediately available funds to the Agent without offset or counterclaim. Whenever any payment due on the Term Loan or under any other Loan Document, shall be stated to be due on a day other than a Business Day, such payment shall be



made on the next succeeding Business Day, and such extension of time shall in such case be included in the computation of payment of interest. Upon receipt of payment from the Borrower, of principal and/or interest, the Agent shall pay each Bank its Pro Rata Share on the same day as the Borrower's said payment, if received by the Agent before noon and otherwise on the next Business Day (which for purposes of this Section 2.4.3 shall mean any day on which commercial banks are open for business in New York, New York). If any payment from the Borrower is received after 2 p.m., the Borrower shall be responsible for interest until the next Business Day.

## **Section 2.5 Interest.**

2.5.1 Revolving Loan Rates. The Borrower shall pay interest on the unpaid principal amount of each Revolving Loan from the date hereof until the principal amount thereof shall be paid in full at the following rates. Each Prime Rate Loan shall bear interest on the unpaid principal amount thereof at a rate per annum equal to the Prime Rate as in effect from day to day as interest accrues. Each LIBOR Rate Loan shall bear interest during each Interest Period applicable thereto at the Revolving LIBOR Loan Rate applicable to such Interest Period. The Agent shall, as soon as practicable after 11:00 a.m., New York City time, two (2) LIBOR Business Days prior to the commencement of a particular Interest Period, determine the LIBOR Rate which will be in effect during such Interest Period and, inform the Borrower and each Bank of the Revolving LIBOR Loan Rate so determined (which determination shall be conclusive and binding upon the Borrower and each Bank absent manifest error). Except as otherwise specifically provided to the contrary, each LIBOR Rate Loan shall bear interest at the Revolving LIBOR Loan Rate so determined from and including the first day of such particular Interest Period to, but not including, the last day of such particular Interest Period.

2.5.2 Term Loan Rate. The Borrower shall pay interest on the unpaid principal amount of the Term Loan from the date thereof until the principal amount thereof shall be paid in full. The Term Loan shall bear interest during each Interest Period applicable thereto at the Term Loan Rate applicable to such Interest Period. The Agent shall, as soon as practical after 9 a.m. New York City time, two (2) LIBOR Business Days prior to the commencement of a particular Interest Period determine the LIBOR Rate which shall in effect during such Interest Period and inform the Borrower and each Bank of the Term Loan Rate so determined (which determination shall be conclusive and binding upon the Borrower absent manifest error). Except as otherwise specifically provided to the contrary, the Term Loan shall bear interest at the Term Loan Rate so determined from and including the first day of such particular Interest Period to, but not including, the last day of such particular Interest Period.

### 2.5.3 Unavailability of LIBOR Rate Based Loans.

(a) In the event, and on each occasion that prior to the commencement of a particular Interest Period, the Agent shall have determined in good faith (which determination shall be conclusive and binding upon the Borrower) that U.S. dollar deposits in an amount approximately equal to the principal balance of such LIBOR Rate Loan, or the Term Loan, as is applicable, and for the relevant maturity, are not available at such time in the London Interbank Market, or reasonable means do not exist for ascertaining a LIBOR Rate for such particular Interest Period, the Agent shall so notify the Borrower and each Bank and the interest for the

LIBOR Rate Loans or Term Loan, as is applicable, shall automatically convert to the Prime Rate as of the Advance Date or next occurring Roll Over Date with respect to such Loan, unless the Borrower notifies the Agent no later than two (2) Business Days prior to the date of such proposed borrowing that its request for such borrowing be canceled or made as an unaffected type of LIBOR Rate Loan, it otherwise being agreed that the Prime Rate shall remain in effect thereafter unless and until the Agent shall have determined in good faith (which determination shall be conclusive and binding upon the Borrower) that the aforesaid circumstances no longer exist, whereupon interest shall again be charged at the Revolving LIBOR Loan Rate or Term Loan Rate, as is applicable, in the manner set forth in this Agreement.

(b) If any change in any law or regulation or in the interpretation thereof by any governmental authority charged with the administration or interpretation thereof shall make it unlawful for any Bank to make or maintain a Loan based upon the LIBOR Rate, or any portion thereof, such Bank shall, within one (1) business day so notify the Agent and the Borrower, whereupon such Bank's obligations hereunder to make or maintain Loans based upon the LIBOR Rate shall be suspended and each affected Loan shall automatically convert to a Prime Rate Loan, unless the Borrower notifies the Agent and each Bank within two (2) Business Days that its request for such proposed borrowing be canceled, or such borrowing be made as an unaffected type of LIBOR Rate Loan, or if such Loan is outstanding that it is concurrently being repaid. Notice given to the Borrower pursuant to this Section 2.5.3 shall be effective on the last day of the then existing Interest Period, unless it shall be unlawful to maintain such LIBOR Rate Loan in which event it shall be effective immediately. Interest at the Prime Rate shall remain in effect unless and until the Agent shall have determined in good faith (which determination shall be conclusive and binding upon the Borrower) that the aforesaid circumstances no longer exist, whereupon interest shall be charged at the Revolving LIBOR Loan Rate or Term Loan Rate, as is applicable, in the manner set forth in this Agreement.

(c) If interest on any Loan is charged at the Prime Rate on and from a date other than a Roll Over Date, the Borrower shall pay to the Agent for the benefit of the Banks, on demand, an amount determined in accordance with Section 2.10 of this Agreement.

2.5.4 LIBOR Rate Costs. The Borrower agrees to pay the Agent, on demand by the Agent, such additional amount or amounts as the Agent shall reasonably determine will compensate the Agent and each Bank for (i) additional costs incurred by any of them, in making or maintaining a LIBOR Rate on a Loan, and (ii) any amount not received, or receivable, by the Agent or any Bank under this Agreement (whether principal, interest or otherwise) as a result of:

2.5.4.1 the imposition after the date of this Agreement of, or changes after the date of this Agreement in the reserve requirements promulgated by the Board of Governors of the Federal Reserve system of the United States, including, but not limited to, any reserve on Eurocurrency Liabilities as defined in Regulation D of the Board of Governors of the Federal Reserve System of the United States at the ratios provided in such Regulation from time to time (it being agreed that the portion of the Loans bearing interest based upon a LIBOR Rate from time to time in accordance with the provisions of this Agreement shall be deemed to constitute Eurocurrency Liabilities, as defined by such Regulation);

2.5.4.2 any change, after the date of this Agreement, in applicable law, rule or regulation or in the interpretation or administration thereof by any domestic or foreign governmental authority charged with the interpretation or administration thereof (whether or not having the force of law) or by any domestic or foreign court changing the basis of taxation or payments to any Bank, as the case may be, of a Loan on which interest is charged based upon the LIBOR Rate or interest based upon the LIBOR Rate Loan or any other fees or amounts payable under this Agreement (other than taxes imposed on all or any portion of the overall net income of such Bank, by the State of New York or the Federal government and other than franchise taxes imposed in lieu of net income taxes), or imposing, modifying or applying any reserve, special deposit or similar requirement against assets of, deposits with or for the account of, credit extended by, or any other acquisition of funds for Loans by the Agent or any Bank or on the London Interbank Market any other condition affecting this Agreement, or the Loan or Loans bearing interest based upon a LIBOR Rate; or

2.5.4.3 any amount or amounts payable by the Borrower to the Agent pursuant to this Section 2.5, or Sections 2.6 or 2.10 of this Agreement shall be paid by the Borrower to the Agent within ten (10) days of receipt by the Borrower from the Agent of a statement setting forth the amount or amounts due and the basis for the determination from time to time of such amount or amounts, which statement shall be conclusive and binding upon the Borrower absent manifest error. Failure on the part of the Agent or a Bank to demand compensation for any increased costs in any Interest Period shall not constitute a waiver of the Agent's or such Bank's right to demand compensation for any increased costs incurred during any such Interest Period or in any other subsequent or prior Interest Period. For the purposes of this Section 2.5.4.3, the Agent shall follow the instructions of the affected Bank. If a Bank cannot make a LIBOR Rate Loan and is therefore obliged to make a Prime Rate Loan, as herein provided, the other Bank or Banks shall have the option to also make a Prime Rate Loan in response to the applicable Notice of Advance.

2.5.5 Default Rate of Interest. Effective immediately upon the occurrence of any Event of Default, and effective retroactively to the date of the Default underlying the Event of Default, without further notice or demand, the principal balance of all Obligations then outstanding and, to the extent permitted by applicable law, any interest payments on the Obligations not paid when due, shall bear interest payable at a rate per annum equal to the Prime Rate plus three (3%) percent.

2.5.6 Computation of Interest. Interest shall be computed on the basis of a year of 360 days and the actual number of days elapsed in the period during which interest accrues. Interest on each Advance shall accrue at the rate specified in Section 2.5.1 of this Agreement from the Advance Date until the Revolving Loan is repaid in full by federal wire transfer or other immediately available funds. Interest on the principal balance of the Term Loan shall accrue at the rate specified in Section 2.5.2 of this Agreement until the Term Loan is repaid in full by federal wire transfer or other immediately available funds.

2.5.7 Interest Payments. Interest accrued on a Prime Rate Loan in any calendar month shall be payable in arrears on the first day of the following month, and on any LIBOR Rate Loan at the end of the Interest Period; and in any event on the Maturity Date. Interest may be charged

to any account maintained by the Borrower with the Agent on the date such payment is due and payable.

2.5.8 Usury. Notwithstanding anything elsewhere contained in the Loan Documents (i) no provision of the Loan Documents shall be deemed to require the payment or to permit the collection of any interest in excess of the maximum rate now or hereafter permitted to be paid or collected under the applicable usury law and (ii) if it should be determined that any amount paid or collected is in excess of such maximum lawful rate, such excess shall, at the election of the Agent, either (a) be credited as a repayment of principal or (b) be deemed to have been paid and collected by mutual mistake of the parties and shall be refunded to the Borrower. Any credit pursuant to this Section 2.5.8 shall reduce the Revolving Loans, and take effect and be applied on the first day after the expiration of the next Roll Over Date.

## **Section 2.6   Increased Costs**

2.6.1 Costs. If either (i) the introduction of or any change in the interpretation of any domestic or foreign law or regulation, or (ii) compliance by the Agent or any Bank with any domestic or foreign guideline, or request from any central bank or other governmental authority (whether or not having the force of law) affects or would affect the amount of capital required or expected to be maintained by the Agent or any Bank or any corporation controlling any Bank, and any Bank reasonably determines that the amount of such capital is increased by or based upon the existence of any Loan made hereunder, then, upon demand by the Agent, the Borrower shall pay to the Agent for such Bank from time to time such additional amounts as may be specified by the Agent as sufficient to compensate it, or as applicable the affected Bank, in light of such circumstances, to the extent that such Bank reasonably determines such increase in capital to be allocable to the maintenance of the Loan. A certificate as to such amounts submitted to the Borrower by the Agent shall, in the absence of manifest error, be conclusive and binding for all purposes. For the purposes of this Section 2.6.1, the Agent shall follow the instructions of the affected Bank.

2.6.2 Taxes. All payments made pursuant to this Agreement or any other Loan Document shall be made free and clear of, and without deduction for, any taxes (as herein defined). If the Borrower shall be required to deduct any taxes in respect of any sum payable under the Notes, or its reimbursement obligations with respect to Letters of Credit or by reason of the Acceptances then the sum payable shall be increased so that the Banks shall receive an amount equal to the sum the Banks would have received had no deductions been made. In the event that the Banks shall pay any taxes required to be deducted by the Borrower, and not deducted, the Borrower shall pay to the Banks on demand, and shall indemnify and hold the Banks harmless from any and all taxes paid by the Banks, and any and all liabilities (including, without limitation, penalties, interest and expenses) with respect thereto, whether or not such taxes were correctly or legally asserted. For the purpose of this Section 2.6.2 only, "taxes" shall mean any and all present and future taxes, levies, imposts, deductions, charges and withholdings in any jurisdiction worldwide, and all liabilities with respect thereto, which are imposed with respect to the Notes, Letters of Credit or Acceptances, or to any amount payable under this Agreement, excluding taxes determined on the basis of the net income of a Person or of any of its offices.

## **Section 2.7 Fees.**

2.7.1 **Unused Fee.** The Borrower shall pay the Agent for the benefit of each Bank, a fee of one quarter of one percent (0.25%) per annum on the daily average of the unused portion of the Revolving Loan Commitment which shall be calculated and be due and payable quarterly in arrears on the first day of October, January, April and July; which fees shall be non-refundable and fully earned on the date due and may be charged to the Borrower accounts at the Agent. The Agent shall remit to each Bank its Pro Rata Share of such fees as provided in Section 2.3.1 of this Agreement.

2.7.2 **Commitment Fee.** The Borrower shall pay the Agent for the benefit of each Bank a Commitment Fee of \$275,000. The Agent shall remit to each Bank its Pro Rata Share of such fee as provided in Section 2.3.1 of this Agreement.

2.7.3 **Agent Fee.** The Borrower shall pay the Agent an agent fee of \$50,000 as a condition of this Agreement becoming effective and shall pay the Agent an additional agent fee of \$81,000 on June 30, 2005, for the period to the Maturity Date, and if the Banks in their discretion should extend the Maturity Date, as a condition of each twelve (12) month extension, the Borrower shall concurrently pay the Agent an amount equal to one eighth of one (1/8%) percent of the then outstanding principal balance of the Term Loan and one eighth and one (1/8%) percent of the Commitment of all of the Banks.

**Section 2.8 Prepayment of Prime Rate Loans.** The Borrower shall have the right to prepay any Prime Rate Loan in whole or in part (but only integral multiples of \$100,000) upon not less than one (1) Business Days prior written notice to the Agent and the Banks, specifying the intended date of prepayment and the amount to be prepaid upon payment of all interest and other sums then due and payable pursuant to the provisions of this Agreement.

**Section 2.9 Prepayment of LIBOR Rate Loans.** The Borrower shall have the right to prepay any LIBOR Rate Loan in whole upon not less than three (3) LIBOR Business Days' prior written irrevocable notice to the Agent prior to the date of said prepayment specifying the intended date of prepayment and the amount to be prepaid and upon payment of all related interest and other sums then due and payable pursuant to the provisions of this Agreement. The LIBOR Rate Loan specified in any such irrevocable notice of prepayment shall, notwithstanding anything to the contrary contained in this Agreement, be absolutely and unconditionally due and payable on the date specified in such notice. No prepayment premium shall be payable if such prepayment occurs on a Roll Over Date. If such prepayment does not occur on a Roll Over Date, the Borrower shall pay to the Agent for the benefit of the Banks contemporaneously with such prepayment an amount equal to any loss or expense by reason thereof, as provided for in Section 2.10.

**Section 2.10 LIBOR Rate Indemnity.** The Borrower shall indemnify the Agent and the Banks against any loss or expense that the Agent or any Bank, as the case may be, may sustain or incur as a consequence of any default by the Borrower in the payment of principal or interest on a LIBOR Rate Loan as and when due and payable, or prepayment of any LIBOR Rate

Loan or conversion thereof occur on a date which is not a Rollover Date thereof, or the occurrence of any Event of Default specified in this Agreement, including, but not limited to, any loss or expense sustained or incurred by the Agent or any Bank in liquidating or re-employing deposits from third parties acquired to effect or maintain a LIBOR Rate with respect to all or any portion of the LIBOR Rate Loan. The Agent shall provide the Borrower with a statement explaining the amount of any such loss or expense, which statement shall be conclusive and binding upon the Borrower absent manifest error.

### **Section 2.11 Letters of Credit.**

2.11.1 Letters of Credit. Subject to the terms and conditions hereof, the Agent, as a Bank, shall issue, or cause one or more of the other Banks to issue, letters of credit (“Letters of Credit”) on behalf of the Borrower; provided, however, that the Agent will not issue or cause to be issued any Letters of Credit: (i) to the extent that the face amount of such Letters of Credit would then cause the Outstanding Revolving Loan Balance plus the outstanding Letters of Credit and Acceptances to exceed the lesser of (a) the Revolving Loan Commitment or (b) the Borrowing Base, (ii) after the Maturity Date or (iii) which have an expiration date which is later than January 15, 2006. In the event there is a draw against a Letter of Credit, which is not reimbursed as provided in the applicable reimbursement agreement or otherwise, the amount of the draw shall be deemed a Revolving Loan for the purposes of the Revolving Facility Amount. All disbursements or payments related to Letters of Credit shall bear interest at the applicable Prime Loan Rate; Letters of Credit that have not been drawn upon shall not bear interest.

2.11.2 Issuance of Letters of Credit. The Borrower may request the Agent, as a Bank, to issue, or request one or more of the other Banks to issue a Letter of Credit by delivering to the Agent its form, or upon the Agent’s request, the Issuer’s form of Letter of Credit application (the “Application”) completed to the satisfaction of the Agent and the Issuer, and such other certificates, documents and other papers and information as the Agent may reasonably request. The Borrower shall provide each Bank with a copy of each such request, including any request to increase an issued Letter of Credit. Each Letter of Credit shall, among other things, provide for the payment of sight drafts or acceptances of drafts when presented for honor thereunder in accordance with the terms thereof, and when accompanied by the documents described therein. Each Documentary Letter of Credit shall be subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision), International Chamber of Commerce Publication No. 500, and any amendments or revision thereof adhered to by the Issuer, and each standby letter of credit shall be subject to the International Standards and Practices for Standby Letters of Credit of the International Chamber of Commerce, effective January 1, 1999 (“ISP98”) and any amendments or revisions thereof adhered to by the Issuer, in each case, to the extent not inconsistent therewith, the laws of the State of New York. The Agent shall use its best efforts to notify each Bank of the request by the Borrower for a Letter of Credit.

### 2.11.3 Requirements For Issuance of Letters of Credit.

2.11.3.1 In connection with the issuance of any Letter of Credit, the Borrower shall indemnify, save and hold the Agent and each Bank harmless from any loss, reasonable cost, expense or liability, including, without limitation, payments made by the Agent or any Bank and

reasonable expenses and reasonable attorneys fees incurred by the Agent or any Bank arising out of, or in connection with, any Letter of Credit to be issued or created for the Borrower. The Borrower shall be bound by the Agent or any Issuer's regulations and reasonable good faith interpretations of any Letter of Credit issued or created for the Borrower's account, although this interpretation may be different from its own; and neither the Agent nor any Bank shall be liable for any error, negligence, or mistakes, whether of omission or commission, in following the Borrower's instructions or those contained in any Letter of Credit, or of any modifications, amendments or supplements thereto or in issuing or paying any Letter of Credit, except for the Agent's, any Bank's, or the Issuer's willful misconduct or gross negligence.

2.11.3.2 If the Agent is not the Issuer of any Letter of Credit, the Borrower shall authorize and direct the Issuer to deliver to Agent all instruments, documents, and other writings and property received by the Issuer pursuant to the Letter of Credit and to accept and rely upon Agent's instructions and agreements with respect to all matters arising in connection with the Letter of Credit, the application therefor or any acceptance therefor.

2.11.3.3 In connection with all Letters of Credit issued or caused to be issued by the Agent under this Agreement, the Borrower hereby appoints the Agent, or its designee, as its attorney-in-fact, with full power and authority, following the occurrence and during the continuance of an Event of Default (i) to sign and/or endorse the Borrower's name upon any warehouse or other receipts, Applications and acceptances; (ii) to sign the Borrower's name on bills of lading; (iii) to clear Inventory through the United States of America Customs Department ("Customs") in the name of the Agent or its designees, and to sign and deliver to Customs officials powers of attorney in the name of the Borrower for such purpose; and (iv) to complete in the Borrower's name or name of the Agent, any order, sale or transaction, obtain the necessary documents in connection therewith, and collect the proceeds thereof. Neither the Agent nor its attorneys will be liable for any acts or omissions nor for any error of judgment or mistakes of fact or law, except for the Agent or its attorney's gross negligence or willful misconduct. This power, being coupled with an interest, is irrevocable as long as there is an Event of Default which has not been (i) cured or (ii) waived in accordance with the terms of this Agreement.

2.11.3.4 Each Bank shall, to the extent of its Pro Rata Share, be deemed to have irrevocably purchased an undivided participation in each unreimbursed reimbursement obligation. In the event that at the time a disbursement is made the Outstanding Revolving Loan Balance exceeds or would exceed, with the making of such disbursement, the Revolving Facility Amount, and such disbursement is not reimbursed by the Borrower within two (2) Business Days, the Agent shall promptly notify the Borrower and each Bank, which notice shall be deemed a Notice of Advance (notwithstanding that the Outstanding Loan Balance exceeds the Revolving Facility Amount) of a Prime Rate Loan in the amount of the disbursement plus interest thereon from the date thereof, plus any unreimbursed costs and expenses relating to such unreimbursed disbursement, all of which shall be set forth in such notice. Each Bank's participation commitment shall continue until the last to occur of any of the following events: (A) the Agent ceases to be obligated to issue or cause to be issued Letters of Credit hereunder, (B) no Letter of Credit issued hereunder remains outstanding and uncanceled or (C) all Persons (other than the Borrower) have been fully reimbursed for all payments made under or relating to Letters of Credit. Any sums expended, in a commercially reasonable manner, by the Agent or

any Bank due to the Borrower's failure to perform or comply with its obligations under this Agreement or any other Loan Document, shall be charged to the Borrower as a Prime Rate Loan and added to the Obligations.

2.11.4 Letter of Credit Fees. The Borrower shall pay to the Agent for the account of the Banks, fees for each Letter of Credit for the period from and excluding the date of issuance of same to and including the date of expiration or termination, (i) in the case of commercial Letters of Credit, a fixed fee equal to one quarter (0.25%) percent of the face amount of each outstanding Letter of Credit, such fee to be payable on the date of issue thereof and quarterly thereafter; and a fixed fee equal to the greater of (a) \$200 or (b) one eighth of one percent (1/8%) such fee to be payable on the negotiation of the Letter of Credit and retained by the Issuer; and (ii) in the case of standby Letters of Credit, a fee equal to the maximum face amount of each outstanding Letter of Credit multiplied by one and fifteen one hundredths (1.15%) percent, such fees to be calculated on the basis of a 360-day year for the actual number of days elapsed and to be payable at the issuance of such Letter of Credit, and (iii) in the case of standby Letters of Credit or commercial Letters of Credit, a fronting fee equal to the greater of (a) \$200, or (b) one-eighth (1/8%) percent and retained by the Issuer, and any and all reasonable fees and expenses as required by the Issuer in connection with any such Letter of Credit, including, without limitation, in connection with the opening, amendment or renewal of any such Letter of Credit and any acceptances created thereunder, and shall reimburse the Agent for any and all reasonable fees and expenses, if any, paid by the Agent or any Issuer. All such fees and expenses shall be deemed earned in full on the date when the same are due and payable hereunder and shall not be subject to rebate or proration upon the termination of this Agreement for any reason. Any such fee or expense in effect at the time of a particular transaction shall be the charge for that transaction, notwithstanding any subsequent change in the Issuer's prevailing fee or expense for that type of transaction. Following the occurrence and during the continuance of an Event of Default, upon demand the Borrower will cause cash to be deposited and maintained in an account with each Bank, as cash collateral pursuant to this Agreement, in an amount equal to each Bank's Pro Rata Share of the outstanding Letters of Credit plus two (2%) percent, and the Borrower hereby irrevocably authorizes each Bank, in its discretion, on the Borrower's behalf and in the Borrower's name, to open such an account and to make and maintain deposits therein, and authorize the Agent to utilize the proceeds of Accounts or other Collateral or any other funds of the Borrower coming into the Agent's possession at any time to fund such accounts.

**Section 2.12 Acceptances**. Subject to the terms and conditions of this Agreement, upon the request of the Borrower, the Issuer will accept drafts presented by the beneficiary of a commercial Letter of Credit, which drafts (i) are being presented to the Agent in accordance with the terms of a commercial Letter of Credit, and (ii) name the Issuer as drawee and the beneficiary as payee and otherwise are in a form acceptable to the Issuer in its sole discretion (each an "Acceptance" and collectively, "Acceptances"). No Acceptance shall have a maturity date which is later than ninety (90) days after its creation date or occurring after January 15, 2006. The Borrower shall pay the Agent for the benefit of the Banks a fee on each Acceptance at a rate equal to one and fifteen one hundredths (1.15%) percent of the full amount of such Acceptance from the date the Acceptance is created to the date of its maturity, such fee to be calculated on the basis of a 360-day year for the actual number of days elapsed, and to be payable on the date the Acceptance is created. In addition, the Borrower shall pay a \$200 administration fee and any



other reasonable costs or expenses of the Issuer.

2.12.1 Acceptance Availability. The aggregate amount available to the Borrower for Acceptances (“Acceptance Availability”) shall be the lesser of: (i) the Borrowing Base, or (ii) \$60,000,000, in either case minus the outstanding (a) Revolving Loans, (b) Letters of Credit, and (c) Acceptances.

2.12.2 Creation of Acceptances. The Agent as a Bank, or any other Bank as an Issuer shall create an Acceptance upon the presentation of a draft by the beneficiary of a commercial Letter of Credit, which draft (i) is being presented to the Issuer in accordance with the terms of a commercial Letter of Credit, and (ii) names the Issuer as drawee and the beneficiary as payee and otherwise is in a form acceptable to the Issuer in its sole discretion. The Borrower hereby constitutes and appoints the Agent, acting by any authorized signatory thereof, the true and lawful attorney-in-fact of the Borrower to sign for and in the name of the Borrower any such draft presented to the Issuer for acceptance and to complete any such draft as appropriate.

2.12.3 Payment of Acceptance Liabilities. Neither the Agent nor any Bank shall have an obligation to discount any Acceptance created hereunder. The sole obligation of the Agent shall be to honor its obligation on the drafts accepted by it in accordance with the provisions of this Section 2.12. With respect to each Acceptance created hereunder, the Borrower unconditionally agrees to pay the Agent for such Acceptance, on the maturity date of such Acceptance, or on such earlier date as may be required pursuant to the terms of this Agreement, the face amount of the Acceptance.

2.12.4 Participation. Each Bank shall, to the extent of its Pro Rata Share, be deemed to have irrevocably purchased an undivided participation in each unreimbursed Acceptance. In the event that at the time a disbursement is made the Outstanding Revolving Loan Balance plus the face amount of any outstanding Letters of Credit and outstanding Acceptance exceed or would exceed, with the making of such disbursement, the Revolving Facility Amount, and such disbursement is not reimbursed by the Borrower within two (2) Business Days, the Agent shall promptly notify the Borrower and each Bank, which notice shall be deemed a Notice of Advance (notwithstanding that the Outstanding Loan Balance exceeds the Revolving Facility Amount) of a Prime Rate Loan in the amount of the disbursement plus interest thereon from the date thereof, plus any unreimbursed costs and expenses relating to such unreimbursed disbursement; all of which shall be set forth in such notice. Each Bank's participation commitment shall continue until the last to occur of any of the following events: (A) the Agent ceases to be obligated to issue or cause to be issued Acceptances hereunder, (B) no Acceptance issued hereunder remains outstanding and uncanceled or (C) the Banks have been fully reimbursed for all payments made under or relating to Acceptances. Any sums expended, in a commercially reasonable manner, by the Agent or any Bank due to the Borrower's failure to perform or comply with its obligations with respect to Acceptances under this Agreement or any other Loan Document, may be charged to the Borrower as a Prime Rate Loan and added to the Obligations.

2.12.5 Indemnification; Conversion of Acceptance Liabilities. The Borrower shall indemnify, save and hold the Agent and each Bank harmless from any loss, cost, reasonable expense or liability, including, without limitation, payments made by the Agent or any Bank and

reasonable expenses and reasonable attorneys' fees incurred by any of them arising out of or in connection with any Acceptance to be issued or created for the Borrower, including but not limited to any loss, cost, expense or liability due to the fact that any of the certifications made pursuant to Section 2.12 of this Agreement proves to have been incorrect in any respect. The foregoing agreement shall be in addition to any rights that the Agent or any Bank may have by reason of any other provision of this Agreement, at common law or otherwise. In addition, in the event that any Acceptance created hereunder is or becomes ineligible for purchase or discount by the Federal Reserve Bank (assuming such Acceptance was accepted and endorsed by a member bank of the Federal Reserve System), the related outstanding liability shall automatically be converted to a Prime Rate Loan, subject to all applicable provisions of this Agreement.

### **ARTICLE 3**

#### **EFFECTIVENESS OF AGREEMENT**

**Section 3.1** **Conditions Precedent.** The effectiveness of this Agreement, and each Bank's Commitment, shall be expressly subject to the Banks' satisfaction, or waiver, of the following conditions precedent, such satisfaction, or waiver, to be evidenced by each Bank's execution of a counterpart of this Agreement:

3.1.1 **Transactions Lawful and Permitted.** The Agent and each Bank shall have received such assurances, as it may request to confirm that the execution and delivery of, and performance under, the Agreement and other Loan Documents (i) have been duly authorized by all necessary corporate action and have received all necessary consents and approvals (including shareholder approval) and have been done with all necessary notifications, registrations and filings, (ii) are permitted by and comply in all respects with the certificate of incorporation and by-laws of each of the Loan Parties and any and all applicable contracts, statutes, and regulations, and rules of common law and equity, and (iii) are not and will not be subject to rescission, avoidance or legal liability.

3.1.2 **Representations and Warranties.** No Default or Event of Default shall have occurred and be continuing and all of the representations and warranties contained in this Agreement or otherwise made to the Agent and/or the Banks pursuant to or in connection with any of the other Loan Documents shall be correct and complete in all material respects.

3.1.3 **Notes.** The Borrower shall have executed and delivered the Revolving Note and Term Note to the Agent.

3.1.4 **Burlen.** Burlen shall have executed and delivered (i) an unlimited guarantee of payment to the Banks of the Obligations in the form of "Exhibit D" annexed hereto, (ii) a security agreement in the form of "Exhibit E" annexed hereto (the "Burlen Security Agreement") granting to the Agent for the benefit of the Banks a first priority perfected security interest in all of its personal property, both tangible and intangible, (iii) a Trademark Security Agreement in the form of "Exhibit F" annexed hereto, and (iv) such other documents as the Agent or the Banks shall reasonably require, including, but not limited to an executed copy of the Agreement pursuant to which the Borrower is purchasing the Burlen Shares.

3.1.5 Pledge. The Borrower shall have executed and delivered a second amendment to the Pledge Agreement, substantially in the form of “Exhibit G” annexed hereto, to the Agent, for the benefit of each Bank, pursuant to which it shall have pledged all of the issued and outstanding Burlen Shares to the Agent for the benefit of the Banks.

3.1.6 Opinions of Counsel. The Banks shall have received a favorable written opinion of Pryor Cashman Sherman & Flynn LLP, special counsel to the Loan Parties in form and substance satisfactory to the Agent, the Banks and their counsel, as to due authorization, due execution, enforceability and such other matters required by the Banks and their counsel and containing such qualifications, limitations and exceptions as are reasonably acceptable to the Agent, the Banks and their counsel.

3.1.7 Proof of Insurance. The Agent shall have received evidence satisfactory to the Banks that the insurance required (i) pursuant to Section 7.5 has been obtained, and (ii) with respect to the Real Estate Assets required pursuant to the terms and provisions of the Real Estate Collateralization Documents.

3.1.8 Fees. The Banks shall have received payment in full of the Agent's and each Bank's fees, including, without limitation, reasonable legal fees incurred in connection with the preparation, negotiation and execution of this Agreement and all other documents delivered pursuant hereto.

3.1.9 Delta Galil Guarantees. The Banks shall have received (i) an executed counterpart of a letter agreement, dated as of the date hereof, between Delta Galil and the Bank amending Delta Galil's Springing Guaranty, dated June 13, 2002, and (ii) a Guaranty from Delta Galil in favor of the Banks, dated as of even date hereof, which is governed by Israeli law.

3.1.10 Auburn Confirmations. The Agent shall have received a confirmation by Auburn of its Guaranty and the Auburn Security Agreement; in the form of Exhibit H annexed hereto.

3.1.11 Other Documents. The Borrower also shall have delivered to the Agent:

3.1.11.1 a copy of the certificate of incorporation of each of the Loan Parties, as amended to the Closing Date, certified to be a true, correct and complete copy thereof by the Secretary of State of the State of its incorporation, or with respect to the Borrower and Auburn, a Certificate executed by its Secretary or Assistant Secretary, certifying that its Certificate of Incorporation has not been amended, restated or otherwise changed since the date of the Restated Agreement, together with a certificate from the Secretary of State in the States in which each of the Loan Parties is incorporated confirming its legal existence and good standing under the laws of such State, and a certificate of the Secretary of State of each State in which any Loan Party is qualified to do business as a foreign corporation to the effect that such Loan Party is in good standing under the laws of such State, each dated a recent date prior to the Closing Date;

3.1.11.2 a copy of the by-laws of each Loan Party certified by its Secretary or Assistant Secretary, to be a true, correct and complete copy of such by-laws as of the Closing

Date; or with respect to the Borrower and Auburn, a certificate signed by its Secretary or Assistant Secretary, certifying that its by-laws have not been amended, restated, repealed or otherwise changed since the date of the Restated Agreement.

3.1.11.3 resolutions of each Loan Party's Board of Directors and an authorized Committee of Delta Galil's Board of Directors approving and authorizing the execution, delivery and performance of each of the Loan Documents to which it is a party, together with a certificate of the Secretary or Assistant Secretary of each Loan Party and Delta Galil dated the Closing Date to the effect that such resolutions have been duly adopted by its Board of Directors, have not been modified or rescinded and remain in full force and effect, and that such resolutions are the only resolutions adopted by its Board of Directors relating to the subject matter thereof;

3.1.11.4 a certificate of the Secretary or Assistant Secretary of each Loan Party and Delta Galil, dated the Closing Date, as to the incumbency and signatures of the officers executing this Agreement or any of the other Loan Documents, on its behalf;

3.1.11.5 original copies of such other Loan Documents executed by the Borrower and Guarantors, acknowledged as appropriate, as may be requested by the Banks in their sole discretion; and

3.1.11.6 filed copies of UCC-1 financing statements identifying Burlen as debtor, listing the Agent as agent for the Banks and the Banks as secured parties, and recorded in all places as are necessary to protect the Lien of the Agent and the Banks in the Burlen Collateral.

3.1.12 Payoff Letter. A "Pay-off letter" from Bank of America N.A. and indemnification letter from Steven A. Klein, both in form and substance satisfactory to the Banks and their counsel.

**Section 3.2 Georgia Properties Conditions Subsequent.** The Borrower as soon as is practical, but in any event no later than February 15, 2005, shall deliver, or cause Burlen to deliver, the following to the Agent for the benefit of the Banks:

3.2.1 Georgia Real Estate Documentation. Such mortgages, deeds of trust, assignments and/or UCC-1 financing statements, each in recordable form, as the Agent may require, in form and substance satisfactory to the Agent, in order to grant to the Banks a first lien and perfected security interest in the Georgia Properties as security for the Obligations (collectively, the "Georgia Real Estate Documentation").

3.2.2 Title Insurance. Policies of title insurance insuring the Georgia Real Estate Documentation as first liens on the Georgia Properties encumbered thereby, free and clear of any other liens or exceptions to title except as may be approved by the Agent.

3.2.3 Surveys. Surveys of the Georgia Properties in form and substance satisfactory to the Agent and certified to the Agent for the benefit of the Banks.

3.2.4 Certificates of Occupancy. If requested and available, certificates of occupancy

for the Georgia Properties issued by the applicable municipal authorities for the locations in which the Real Estate Assets are located and authorizing the current use of the Georgia Properties.

3.2.5 Insurance. Insurance with respect to the Georgia Properties required pursuant to the terms and provisions of the Georgia Real Estate Documentation.

3.2.6 Appraisals and Environmental Reports. Such appraisals and environmental reports as the Banks shall reasonably require.

3.2.7 Leases. Certification by Borrower as to all tenancies or rights of possession or other agreements pertaining to or affecting the Georgia Properties.

3.2.8 Further Assurances. Such additional documentation and information as the Banks or their counsel shall reasonably require following review of the documents provided pursuant to Sections 3.2.1, 3.2.2, 3.2.3, 3.2.4 ,3.2.5, 3.2.6 and 3.2.7.

**Section 3.3 Pennsylvania and North Carolina Properties Conditions Subsequent**. The Borrower as soon as is practical, but in any event no later than January 31, 2005, shall deliver, or cause Auburn to deliver, the following to the Agent for the benefit of the Banks.

3.3.1 Real Estate Collateralization Documents. The Agent shall have received for the benefit of the Banks the Real Estate Collateralization Documents and related documents listed on Schedule 3.3.1 annexed hereto.

3.3.2 Title Insurance. Policies of title insurance insuring the Real Estate Collateralization Documentation as first liens on the respective portions of the Real Estate Assets encumbered thereby, free and clear of any other Liens or exceptions to title except as may be approved by the Agent.

3.3.3 Lessor Estoppel and Waiver. Delivery to the Agent of an estoppel and waiver agreement, in form and substance satisfactory to the Agent, from the lessor under the lease for 3607 West Fourth Street, Williamsport, Pennsylvania, certifying, among other things, that no defaults exist thereunder, waiving any landlord's lien with respect to the Borrower's personal property located at the said premises and consenting to the assignment of the said leases to the Agent for the benefit of the Banks, or its designee, upon the occurrence of an Event of Default.

3.3.4 Opinions of Counsel. The Banks shall have received a favorable written opinion of (i) special Pennsylvania Counsel to the Borrower, and (ii) special North Carolina counsel to the Borrower, each such counsel to be acceptable to the Agent, with respect to the Real Estate Collateralization Documents applicable to the Real Estate Assets in such counsel's State, each in form and substance satisfactory to the Agent, the Banks and their counsel, as to due authorization, due execution, enforceability and such other matters required by the Banks and their counsel and containing such qualifications, limitations and exceptions as are reasonably acceptable to the Agent, the Banks and their counsel.

**Section 3.4** **Conditions Subsequent.** The Borrower as soon as practical, but in any event within the time periods specified below, shall deliver or cause to be delivered to the Agent.

3.4.1 **Burlen Stock Certificates and Stock Powers.** Within three (3) business days, the stock certificate or stock certificates evidencing the Burlen Shares, and such stock powers, or documents, as would permit the Agent to transfer legal and beneficial ownership of the Burlen Shares.

3.4.2 **Termination of Bank of America Liens on Personal Property .** Within three (3) business days, evidence that all UCC-1 Financing Statements in favor of Bank of America N.A., as secured party naming Burlen, as debtor, have been terminated.

3.4.3 **Opinion of Georgia Counsel.** Within six (6) business days a favorable written opinion of special counsel to Burlen, similar in form and substance to the opinion delivered pursuant by Pryor Cashman Sherman & Flynn LLP pursuant to Section 3.1.6 of this Agreement, and which shall include a favorable opinion as the form of UCC-1 Financing Statement filed, or to be filed by the Agent with respect to the Burlen Collateral and as to the proper place of filing of the UCC-1 Financing Statement.

3.4.4 **Termination of Bank of America N.A. Mortgages.** Not later than February 15, 2005, evidence that the mortgages held by Bank of America on the Georgia Properties have been terminated of record.

3.4.5 **Opinion With Respect to Guaranties.** Within ten (10) Business Days from the Closing Date, the Banks shall have received (x) a written opinion of Pryor Cashman Sherman & Flynn LLP, special counsel to Delta Galil, in form and substance satisfactory to the Banks and their counsel, to the effect that the Springing Guaranty dated June 13, 2002, as amended, is a valid and binding obligation of Delta Galil, enforceable in accordance with its terms under the laws of the State of New York, and (y) an opinion from Israeli counsel substantially similar to the opinion received by the Agent from I Amihud Ben-Porath, Hamou & Co. dated June 13, 2002, with respect to said Springing Guaranty. Within ten (10) Business Days from the Closing Date, the Banks shall also receive a written opinion from Israeli counsel, in form and substance satisfactory to the Banks and their counsel, and covering such matters as they shall reasonably request, with respect to a guaranty dated as of the Closing Date by Delta Galil of all of the Obligations of the Borrower in favor of the Banks (which guaranty shall be in Hebrew and governed by the laws of the State of Israel).

## **ARTICLE 4**

### **CONDITIONS TO ADVANCES, ETC.**

The obligation to make an Advance, make the Term Loan, issue a Letter of Credit or create an Acceptance shall be expressly subject to the satisfaction of the following conditions precedent:

**Section 4.1** **Representations and Warranties.** All of the representations and

warranties of the Borrower and the Guarantors contained herein shall be true and correct in all material respects to the same extent as though made on and as of any Advance Date, the date of the issuance of the Letter of Credit, or the date of the creation of an Acceptance, as is applicable.

**Section 4.2** **No Default.** No Default or Event of Default shall have occurred or shall result from the making of the requested Advance, issuing the Letter of Credit or creating the Acceptance.

**Section 4.3** **Material Adverse Change.** No adverse change deemed material by the Required Lenders in their sole and absolute discretion (provided, however, that the Required Lenders give the Agent and the other Banks notice thereof), in the financial condition, operations, properties, business, management or ownership of any of the Loan Parties or Delta Galil, or of any of the Loan Parties', or Delta Galil's business or financial prospects, or the risks associated with the transaction contemplated by this Agreement, shall have occurred.

**Section 4.4** **Liens.** The Agent for the benefit of the Banks shall hold valid, enforceable and perfected first priority Liens, in and to all of the Collateral, the Auburn Collateral, and the Burlen Collateral. included in the Borrowing Base, subject only to the Permitted Encumbrances and Liens permitted pursuant to Section 8.1 of this Agreement.

**Section 4.5** **No Obstacle.** No law or regulation shall prohibit, and no order, judgment or decree of any court, arbitrator or governmental authority shall enjoin or restrain, any Bank from making the requested Advance, Term Loan, Letter of Credit or Acceptance.

**Section 4.6** **Borrowing Base.** After giving effect to the amount of the requested Advance, Letter of Credit or Acceptance, the aggregate amount of the Outstanding Revolving Loan Balance, outstanding Letters of Credit, and Acceptances, do not exceed the Revolving Facility Amount.

**Section 4.7** **Other Requirements.** The Agent shall have received such other documents and evidence with respect to the transactions contemplated by this Agreement, in form and substance satisfactory to the Banks, as they may reasonably request.

## **ARTICLE 5**

### **COLLATERAL**

**Section 5.1** **Security Interest.** To secure payment of the Obligations, the Original Borrowers pursuant to the Original Agreement granted to the Agent, as agent for the Banks, a continuing security interest in and to all of the property and assets of the Original Borrowers to secure the Obligations. The Borrower, as successor in interest to the Original Borrowers, does hereby ratify, confirm and continue such grant. Accordingly, the Borrower hereby grants to the Agent, for the ratable benefit of each Bank, a continuing security interest in and to all of the assets and properties of the Borrower, whether now owned or hereafter acquired and wherever located, including without limitation, all (i) Accounts; (ii) Inventory; (iii) Equipment; (iv) General Intangibles; (v) notes, drafts, letters of credit, debt and equity securities (including but

not limited to certain of the Honduras Shares, and the Auburn Shares and the Burlen Shares), whether or not certificated, warrants, options, puts and calls and other rights to acquire or otherwise relating to equity securities and other instruments of any nature whatsoever; (vi) chattel paper and all bills of lading, warehouse receipts and other documents of title; (vii) property or interests in property now or hereafter coming into the possession, custody or control of the Agent or any of the Banks in any way or for any purpose (whether for safekeeping, deposit, custody, pledge, transmission, collection or otherwise); (viii) proceeds of any loans made to the Borrower; (ix) deposit accounts, monies, securities or other property or bank balances held by the Agent or any of the Banks or any affiliate thereof; (x) insurance proceeds of or relating to any of the foregoing; (xi) books and records relating to any of the foregoing and to the business of the Borrower including without limitation, any computer programming data relating to the foregoing; and (xii) accessions and additions to, substitutions for and replacements, products and proceeds of any of the foregoing.

## **Section 5.2 The Agent as Borrower's Attorney-in-Fact.**

5.2.1 Appointment. Pursuant to the Original Agreement the Original Borrowers appointed the Agent, or any other person whom the Agent may designate, as their attorney-in-fact, coupled with an interest, which power of attorney is hereby confirmed and ratified by the Borrower, with full power of substitution and with full power from time to time in the Borrower's stead: (i) to file any and all financing statements, modifications and continuations in respect of the Collateral and the transactions contemplated by this Agreement and the other Loan Documents in any jurisdiction which the Agent deems appropriate with respect to any Collateral, and the Borrower agrees to reimburse the Agent for the reasonable expense of any such filing including reasonable attorneys fees; (ii) to file a carbon, photographic or other reproduction of this Agreement or of a financing statement if the Agent deems such filing necessary or desirable under applicable law; (iii) to send requests for verification of Accounts to customers or Account Debtors as long as such requests do not identify the Agent or any Bank; (iv) after the occurrence and during the continuation of an Event of Default (A) to endorse the Borrower's name on any checks, notes, acceptances, money orders, drafts or other forms of payment or security that may come into the Agent or any Bank's possession; (B) to sign the Borrower's name on any invoice or bill of lading relating to any Account, on drafts against customers, on schedules and assignments of Accounts, on notices of assignment, on verifications of Accounts and on notices to customers; (C) to notify the post office authorities to change the address for delivery of the Borrower's mail to an address designated by the Agent; (D) to receive, open and dispose of all mail addressed to the Borrower; (E) to file any claims or take any action or institute any proceeding which the Agent deems necessary or desirable for the collection of any Collateral or otherwise to enforce or protect its rights with respect to the Collateral, including but not limited to any notification to any account debtors of the Borrower; (F) to pay or discharge taxes, liens, security interests or other encumbrances levied or placed on or threatened against the Collateral, to effect any repairs with the proceeds of any insurance called for by the terms of this Agreement and to pay all or any part of the premiums therefor and the costs thereof; (G) to direct any party liable for any payment under any of the Collateral to make payment of any and all moneys due, and to become due thereunder, directly to the Agent or as the Agent shall direct; (H) to receive payment of and receipt for any and all moneys, claims and other amounts due, and to become due at any time, in respect of or arising out of any Collateral; (I) to sign and indorse any invoices, assignments,



verifications and notices in connection with accounts and other documents constituting or relating to the Collateral; (J) to commence and prosecute any suits, actions or proceedings at law or in equity in any court of competent jurisdiction to collect the Collateral or any part hereof and to enforce any other right in respect of any Collateral; (K) to defend any suit, action or proceeding brought against the Borrower with respect to any Collateral; (L) to settle, compromise or adjust any suit, action or proceeding described above and, in connection therewith, to give such discharges or releases as the Banks may deem appropriate; (M) to license or, to the extent permitted by an applicable license, sublicense, whether general, special or otherwise, and whether on an exclusive or non-exclusive basis, any patent or trademark, throughout the world for such term or terms, on such conditions, and in such manner, as the Required Lenders shall in their sole discretion determine; (N) generally to sell, transfer, pledge, make any agreement with respect to or otherwise deal with any of the Collateral as fully and completely as though the Agent were the absolute owner thereof for all purposes, and to do, at the Agent's option and the Borrower's expense, at any time, or from time to time, all acts and things which the Agent reasonably deems necessary to protect, preserve or realize upon the Collateral and the Liens of the Agent and the Banks therein, in order to effect the intent of this Agreement, all as fully and effectively as the Borrower might do; (O) to ask, demand, collect, sue for, recover and receive moneys due and to become due under or in respect of any of the Collateral; or (P) to obtain and adjust insurance required to be maintained pursuant to the within Agreement; and (v) to do all things necessary to perfect the Agent's and each Bank's Lien in the Collateral, to preserve and protect the Collateral and to otherwise carry out this Agreement. This power being coupled with an interest is irrevocable until the Obligations have been fully satisfied or the financing arrangements between the Banks and Borrower are terminated, whichever shall later occur.

5.2.2 Ratification of Acts. The Borrower hereby ratifies, to the extent permitted by law, all that the attorneys acting pursuant to this subsection shall lawfully, and in good faith do or cause to be done by virtue hereof.

5.2.3 Limitation on Liability. The powers conferred on the Agent hereunder are solely to protect the Banks' interest in the Collateral and shall not impose any duty upon the Agent to exercise any such powers. The Agent and each of the Banks shall be accountable only for amounts that it actually receives as a result of the exercise of such powers and neither the Agent, any of the Banks nor any of the officers, directors, employees or agents shall be responsible to the Borrower for any act or failure to act, except for their own gross negligence or willful misconduct.

5.2.4 Additional Powers. The Borrower also authorizes the Agent, in addition to its rights and remedies under the Uniform Commercial Code, at any time and from time to time upon the occurrence and during the continuance of any Event of Default or upon the nonpayment of any or all of the Obligations, after demand for payment, (i) to communicate in the Agent's or any Bank's own name with any party to any contract with regard to the assignment of the right, title and interest of the Borrower in and under the contracts hereunder and other matters relating thereto, and (ii) to execute, in connection with the sale provided for herein, any endorsements, assignments or other instruments of conveyance or transfer with respect to the Collateral.

**Section 5.3 Trademark Security Agreement.** To secure payment of the Obligations the Original Borrowers, pursuant to the Original Agreement, entered into a Trademark Security Agreement with the Agent wherein and whereby the Agent, as agent for the Banks, was granted a security interest in certain Trademarks (as therein defined), which Trademark Security Agreement was Amended and Restated concurrently with the execution and delivery of the Restated Agreement. The Borrower hereby ratifies and confirms the Amended and Restated Trademark Security Agreement, and represents and warrants to the Agent and the Banks, that the Amended and Restated Trademark Security Agreement is complete and correct and continues to secure the Loans and other Obligations.

**Section 5.4 Real Estate Assets.** To secure payment of the Obligations, the Original Borrowers, pursuant to the Original Agreement, and the Borrower pursuant to the June 14, 2002 Amendment thereto, granted to the Agent as agent for the Banks, mortgages, assignments, pledges and/or other Liens on the Real Estate Assets, other than the Borrower's lease for its Premises in Secaucus, New Jersey. The Borrower hereby ratifies and confirms the Real Estate Collateralization Documents as amended or restated concurrently herewith or hereafter pursuant to this Agreement, and represents and warrants to the Agent and the Banks that the Liens and other interests granted to the Agent, as agent for the Banks in the Real Estate Assets remain in full force and effect as of the date hereof and continue to secure the Loans and other Obligations.

**Section 5.5 Additional Collateral.** Concurrently with the execution and delivery of this Agreement, (i) Burlen is granting to the Bank a security interest and Lien on the Burlen Collateral pursuant to the Burlen Security Agreement, and (ii) the Borrower, pursuant to an amendment to the Pledge Agreement, as provided for in Section 3.1.5 hereof, is pledging the Burlen Shares to the Banks.

## **ARTICLE 6**

### **REPRESENTATIONS AND WARRANTIES**

The Borrower represents and warrants to the Agent and each of the Banks as follows (each such representation and warranty deemed to be repeated on each Advance Date):

#### **Section 6.1 Corporate Matters.**

6.1.1 **Existence and Ownership.** The Borrower and each Guarantor is a corporation duly organized, validly existing and in good standing under the laws of the state of its formation and is duly qualified as a foreign corporation and in good standing in all states where the nature and extent of the business transacted by it or the ownership of its assets makes such qualification necessary, except for those states in which the failure to qualify would not have a Material Adverse Effect. Schedule 6.1 annexed hereto, lists the legal and beneficial owners of all of the issued and outstanding shares of capital stock of the Borrower. The Borrower is the legal and beneficial owner of the Auburn Shares and the Burlen Shares.

6.1.2 **Bi-Annual Reports.** Each of the Loan Parties has filed all annual or bi-annual reports required to be filed by each of them in its state of incorporation and each state in which it

has qualified to do business.

**Section 6.2 Corporate Authority; Non-Contravention.** The execution, delivery and performance by the Borrower of this Agreement and by the Borrower and the Guarantors of all other Loan Documents as to which they are parties are within the Borrower's and each Guarantor's corporate powers, have been duly authorized by all necessary corporate action, and require no action by or in respect of, or filing with, any governmental body, agency or official and do not contravene, or constitute a default under, any provision of applicable law or regulation or of the certificate of incorporation or bylaws of the Borrower or any Guarantor of any agreement, judgment, injunction, order, decree or other instrument binding upon the Borrower or any Guarantor or result in the creation or imposition of any Lien (other than any Lien created pursuant to the terms of the Loan Documents) on any asset of the Borrower or any Affiliate, except for any such contravention, default or Lien as would not have a Material Adverse Effect.

**Section 6.3 Binding Effect.** This Agreement and all other Loan Documents and the Obligations are the legal, valid and binding obligations of such of the Borrower and the Guarantors as are party thereto and are enforceable against the Borrower and such Guarantor as are parties thereof in accordance with their respective terms, except as limited by applicable bankruptcy, reorganization, insolvency, moratorium, receivership or similar laws affecting or relating to the enforcement of creditors' rights generally and by general equitable principles (regardless of whether enforcement is sought in a proceeding in equity or at law).

**Section 6.4 Collateral.** The Borrower has good, indefeasible, and merchantable title to and ownership of the Collateral, free and clear of all Liens except for the Liens permitted by Section 8.1 of this Agreement. All of the Collateral, Auburn Collateral and Burlen Collateral and other assets and properties of each Loan Party are currently maintained and insured as required by this Agreement and the Security Agreements. Each Account (including all Eligible Accounts) listed or referred to on any trial balance, balance sheet or the books or records of any Loan Party, or referred to in any report to the Agent or any Bank (other than Accounts which are proceeds of letters of credit, insurance proceeds, contract rights, chattel paper, instruments and documents not arising directly out of a sale or lease of goods or services) is and will be free and clear of Liens in favor of any Person other than the Agent and the Banks as provided in this Agreement, will cover a bona fide sale and delivery of goods usually dealt in by such Loan Party in the ordinary course of its business, and will be for a liquidated amount from a customer competent to contract therefor and maturing as stated in the applicable Loan Party's assignment thereof to the Agent. The Equipment is in good working order and condition, ordinary wear and tear excepted, and is used or usable in the current conduct of the Loan Parties' businesses, and each of the Loan Parties has all of the machinery and equipment necessary to the current conduct of its businesses. The Honduras Shares pledged to the Agent represent 65.6% of the issued and outstanding shares of capital stock of Wundies de Honduras (the "Pledged Honduras Shares"). The Auburn Shares and Burlen Shares pledged by the Borrower represent all of the issued and outstanding capital stock of Auburn and Burlen. The Borrower has all voting rights with respect to the Pledged Honduras Shares, the Auburn Shares and the Burlen Shares and there are no warrants, options or rights in any Person to acquire the Pledge Honduras Shares, the Auburn Shares, the Burlen Shares or any other equity interest in Wundies de Honduras, Auburn or

Burlen, except that one (1) Honduras Share is owned by each of Michael Fitzgerald, Judith Moore, William Mull, Jr. and Steven Lockcuff. The Banks have a first priority perfected lien on the Pledged Honduras Shares and Auburn Shares and upon compliance by the Borrower with Section 3.1.5 of this Agreement, the Banks will have a first priority perfected lien on all of the Burlen Shares.

**Section 6.5** **Place of Business.** The principal place of business and chief executive office of the Borrower is set forth in the first paragraph of this Agreement. The books and records of the Borrower and records concerning the Eligible Accounts are located at 150 Meadowlands Parkway, Seacaucus, New Jersey. All Inventory and Equipment of each of the Loan Parties is located at the places set forth on Schedule 6.5 annexed hereto.

**Section 6.6** **Corporate Names.** Within the past five (5) years, no Loan Party has been known by any corporate or fictitious name, except (i) that the Borrower, prior to the Merger, was known by the names of the Original Borrowers, and (ii) as provided in Schedule 6.6 annexed hereto.

**Section 6.7** **Tax Liabilities.** The Borrower and the Guarantors have filed all tax returns for and paid in full all federal, state and local taxes (including all applicable payroll taxes) to the extent such filings and payments required to be made prior to the date of this Agreement. All of such returns are true, correct and complete. The Borrower does not have any knowledge of any deficiency or additional assessment in connection with any of the foregoing tax returns, not provided for on its or the applicable Guarantor's books, or reserved against its or the applicable Guarantor books.

**Section 6.8** **Other Agreements.** Neither the Borrower nor any Guarantor is in default under any contract, lease or commitment to which it is a party or by which it or any of its property is bound in any respect which would result in a Material Adverse Effect nor knows of any dispute regarding any contract, lease, or commitment which would result in a Material Adverse Effect.

**Section 6.9** **Employee Controversies.** There are no controversies pending or, to the best of the Borrower's knowledge after diligent inquiry, threatened between any of the Loan Parties and any of their employees, other than employee grievances arising in the ordinary course of business and those which are not, in the aggregate, expected to have a Material Adverse Effect.

**Section 6.10** **Compliance with Laws and Regulations.** Each of the Loan Parties is in compliance in all respects with all laws, orders, rules, regulations, requirements, and ordinances of all federal, foreign, state and local governmental or quasi-governmental authorities, and any judicial or administrative interpretations thereof, applicable to its business, operations and assets and all permits, licenses, certificates, approvals, authorization, consents, or registrations required or obtained thereunder, for which the failure to comply therewith would have a Material Adverse Effect.

**Section 6.11** **Intellectual Property.** Each of the Loan Parties owns or possesses all of

the material licenses, patents, patent applications, copyrights, service marks, trademarks and trade names necessary for it to continue to conduct its business as heretofore conducted by it, all of which are listed on Schedule 6.11 annexed hereto.

**Section 6.12 Pension Matters.** Except as set forth on Schedule 8.14 annexed hereto, no Loan Party has any Plan except for a plan established under Internal Revenue Code 401(k) which plan is conducted, maintained and administered in accordance with all applicable laws in all material respects.

**Section 6.13 Financial Statements.** The Borrower has delivered to the Agent its financial statements for its fiscal years ending December 31, 2003 and the nine (9) month period ending September 30, 2004 which are complete, correct and represent in all material respects the financial position of the Borrower and Auburn on a consolidated and consolidating basis as of the respective dates thereof, and the result of the operations of the Borrower and Auburn for the periods covered by such financial statements subject to normal and customary adjustments for those statements that are not audited. The Borrower has delivered to the Agent a Financial Statement for Burlen for the Fiscal year ending January 2, 2004 which is complete, correct and represents in all material respects the financial position of Burlen as of such date and the results of operations of Burlen for such period, subject to normal customary year end adjustments. Since the date of such financial statements of the Loan Parties (the "Financial Statements"), there has not been any material adverse change in the financial condition, assets, liabilities, business or operations of the Borrower or Auburn.

**Section 6.14 Disclosure.** No representation or warranty by the Borrower or any Guarantor made to the Agent or any Bank contained in this Agreement or any other document, certificate or written statement furnished by or on behalf of the Borrower or any Guarantor for use in connection with the transactions contemplated by this Agreement (including, without limitation, the Financial Statements) contains any untrue statement of material fact or omits to state a material fact necessary in order to make the statements contained herein or therein, in the light of the circumstances under which they were made, not misleading. The Borrower has not withheld any fact known to it which materially adversely affects its or any Guarantor's business, operation, assets or conditions (financial or otherwise) which has not been disclosed herein or in such other documents, certificates and statements furnished to the Banks and the Agent on or before the date hereof for use in connection with transactions contemplated hereby.

**Section 6.15 Loans.** After giving effect to this Agreement, except for the Obligations, unsecured obligations to suppliers of goods and services incurred and currently payable by the Loan Parties in the ordinary course of business subsequent to the date of the Financial Statements and as disclosed on the Financial Statements, as of the Closing Date, the Loan Parties have no other Indebtedness.

**Section 6.16 Margin and Investment Company Act.** No Loan Party owns any margin security, and the proceeds of the Loans will not be used for the purpose of purchasing or carrying any margin securities or for the purpose of reducing or retiring any Indebtedness which was originally incurred to purchase or carry any margin securities or for any other purpose not permitted by Regulation U or X of the Federal Reserve Board. No Loan Party is an "investment

company” or a company “controlled” by an investment company within the meaning of the Investment Company Act of 1940, as amended.

**Section 6.17 Parent, Subsidiaries and Other Interests.** The Borrower has no subsidiaries and owns no interest in any corporation, partnership or joint venture except (i) Wundies de Honduras, (ii) Auburn, (iii) Burlen, and (iv) as set forth on Schedule 6.17 annexed hereto.

**Section 6.18 Litigation and Proceedings.** Except as set forth in Schedule 6.18 annexed hereto, no judgments are outstanding against any of the Loan Parties and, to the best of the Borrower’s knowledge after diligent inquiry, there is not now pending or threatened any litigation, contested claim or government proceeding, claim, assertion or investigation by or against any of the Loan Parties, except pending or threatened litigation fully covered by insurance and contested claims which arose in the ordinary course of business and, in the aggregate, seek recovery of less than \$50,000.

**Section 6.19 Environmental Matters.** Except as set forth on Schedule 6.19 annexed hereto, (i) the business and operations of the Loan Parties and the condition of their assets, property and the Premises comply in all material respects with all applicable Environmental Law and Environmental Permits; (ii) there has been no Release, or threat of Release in either case in violation of any Environmental Law, from, at or about the Premises or any property now or previously used by any of the Loan Parties or their businesses or operations or for the transport, storage or disposal of any of their assets or wastes; (iii) to the knowledge of the Borrower there has not been any injury to the Environment, in violation of any Environmental Law, including any person, property, animal life or vegetation, caused by any Release or threatened Release on the Premises or as a result of the transport, storage or disposal of any of its assets or wastes; (iv) to the knowledge of the Borrower there is and has been no investigation, proceeding, complaint, order, directive, claim, citation or notice alleging violation of any Environmental Law by any Person past, pending or threatened, affecting the Premises, any of the Loan Parties, or any present or prior tenant, user, owner, operator, or any other person in any way related to any of the foregoing, or their businesses, operations, assets, equipment, property, leaseholds, or other facilities, or any properties at which any of the Loan Parties transported, stored or disposed of any Hazardous Substances, or any property near any of the foregoing, with respect to (a) Releases or threats of Release (b) air emissions, (c) spills, releases or discharges to sewer, septic system or waste treatment, storage or disposal systems, (d) noise emissions, (e) solid or liquid waste disposal, (f) the use, generation, storage, transportation or disposal of Hazardous Substances, (g) alleged violations of any Environmental Law, (h) any other environmental, health or safety matters, (any of which (iv)(a) through (h) is hereafter referred to as an “Environmental Complaint”); (v) each of the Loan Parties have filed all notices required to be filed under any Environmental Law indicating past or present treatment, storage, use or disposal of Hazardous Substances or reporting Release(s); (vi) to the knowledge of the Borrower, no Loan Party has any material contingent liability in connection with any past or present Release or threatened Release in violation of any Environmental Law; (vii) the Borrower has no knowledge of any condition concerning the Environment or affecting any of the Premises; and (viii) the Premises are not currently used, nor to the knowledge of the Borrower have they been used in the past, by any Person in a manner which violates any Environmental Law or which could give rise

to liability for Hazardous Substances, nor do conditions exist on or affect the Premises which could violate any such law or give rise to such liability.

**Section 6.20 The Real Estate Assets.**

6.20.1 Improvements. Except as set forth on Schedule 6.19 annexed hereto, the improvements on the respective parcels of real property constituting the Real Estate Assets (the "Improvements") and the present use thereof do not violate in any material respect (i) any restrictive covenants or other agreements applicable thereto, or (ii) any federal, state or municipal laws, regulations or requirements (including, without limitation, any zoning, building, subdivision or Environmental law, regulations or requirements), and neither the Borrower nor Auburn has received nor is the Borrower aware of any notice of the violation of the same.

6.20.2 Certificates of Occupancy. All required certificates of occupancy for the use, occupancy and operation of the Improvements have been issued and are in full force and effect and the Borrower is not aware of any pending or threatened action or proceeding to revoke or modify the same.

6.20.3 Condition. No material part of the Improvements has been damaged (by fire or otherwise) in any material respect and not repaired, or in the process of being repaired, nor taken in condemnation or in any other like proceeding, nor is any condemnation or like proceeding pending with respect to any of the Real Estate Assets.

6.20.4 Leases. As of the Closing Date, other than the Leases, there are no leases, tenancies or occupancies, or agreements, written or oral, or Person other than the Loan Parties in, or entitled to, possession of any portion of the Real Estate Assets.

6.20.5 No Defaults. Neither the Borrower nor Auburn is in any respect in default in the performance of any of the terms or provisions of any of the Leases, nor is there are any fact or condition which, with notice or lapse of time or both, would become such a default. There are no understandings, contracts, agreements or commitments of any kind whatsoever with respect to any of the Leases or the premises covered thereby except as expressly provided for in the Leases.

6.20.6 Judgments. Except as set forth in Schedule 6.19, there are no Liens, judgments, actions or proceedings filed or pending against any of the Real Estate Assets, other than first mortgages held by Bank of America N.A. on the Georgia Properties, and Liens in favor of the Agent for the benefit of the Banks.

6.20.7 Real Estate Assets. As of the Closing Date, the Real Estate Assets constitute all of the Borrower's real estate and direct, or indirect interests in real estate, and there has been no material decrease in the value of the Real Estate Assets since September 11, 2000.

**Section 6.21 Dissolution of Affiliates.** The Borrower has caused In-Touch Communications, Inc., a Delaware corporation, to be liquidated and dissolved.

**Section 6.22 Release of Liens of Record.** The Borrower has terminated, or cause to be

terminated, all UCC financing statements naming the CIT Group/Commercial Services, Inc. and/or Capital Factors, Inc., as secured party, and the Borrower, as debtor.

## ARTICLE 7

### AFFIRMATIVE COVENANTS

The Borrower covenants and agrees that so long as this Agreement remains in effect (whether or not there are any outstanding Obligations):

**Section 7.1** **Financial Statements.** Each of the Loan Parties shall keep proper books and records in accordance with a consistent application (except as otherwise consented to by the Agent) of GAAP in which full and true entries will be made of all dealings or transactions of or in relation to its business and affairs. Each of the Loan Parties shall at all times hereunder (i) keep correct and accurate records itemizing and describing the kind, type, location, quality and quantity of Inventory, its cost therefor, daily withdrawals therefrom and accessions thereto, and (ii) keep correct and accurate records itemizing and describing the kind, type, age and condition of the Equipment, together with records of its cost therefor and all accumulated depreciation thereof. The Borrower shall deliver to the Agent for the benefit of the Banks:

7.1.1 as soon as practicable but in any event within sixty (60) days after the end of each of first and third fiscal quarters (a) consolidated and consolidating statements of income, profits and losses, and retained earnings of the Loan Parties for such quarter, setting forth, in comparative form, budgeted figures for such quarter and actual figures for the corresponding quarter in the preceding fiscal year, and consolidated and consolidating balance sheet of the Loan Parties as of the end such quarter, setting forth, in comparative form, actual figures as at the end of the corresponding quarter in the preceding fiscal year, all in reasonable detail and certified as accurate by the Chief Executive Officer, Chief Financial Officer or Chief Operating Officer of the Borrower, subject to changes resulting from normal year-end adjustments, and (b) consolidated and consolidating operating statements for the Loan Parties for such quarter including, without limitation, statements of cash flow and analysis of working capital and other data as the Agent may reasonably request, and a comparison of actual cash flow and working capital with budgeted amounts for such quarter;

7.1.2 as soon as practicable but in any event within sixty (60) days after the end of the Borrower's fiscal six (6) month period (a) consolidated and consolidating statements of income, profits and losses, and retained earnings of the Loan Parties for such period, setting forth in comparative form, budgeted figures for such six (6) month period and actual figures for the corresponding six (6) month period in the preceding fiscal year, and consolidated and consolidating balance sheets of the Loan Parties as of the end such six (6) month period, setting forth, in comparative form, actual figures as at the end of the corresponding six (6) month period in the preceding fiscal year, all in reasonable detail, reviewed by independent public accounts selected by the Borrower and satisfactory to the Agent, subject to changes resulting from normal year-end adjustments, and (b) consolidated and consolidating operating statements for the Loan Parties for such six (6) month period including, without limitation, statements of cash flow and analysis of working capital and other data as the Agent or the Banks may reasonably request, and



a comparison of actual cash flow and working capital with budgeted amounts for such period;

7.1.3 as soon as practicable but in any event within ninety (90) days after the end of each fiscal year, consolidated and consolidating statements of income, retained earnings and changes in financial condition for the Loan Parties for such year, and a consolidated and consolidating balance sheet of the Loan Parties as of the end of such year, all with supporting schedules setting forth in each case, in comparative form, corresponding figures for the period covered by the preceding annual audit and as of the end of the preceding fiscal year, certified by PricewaterhouseCoopers LLP independent public accountants, or such other nationally recognized firm of certified public accountants as has been selected by the Borrower and is satisfactory to the Agent, whose opinion shall be unqualified and otherwise in scope and substance reasonably satisfactory to the Agent;

7.1.4 as soon as practicable but in any event not more than three (3) Business Days after the Chief Executive Officer, Chief Financial Officer or Chief Operating Officer of the Borrower obtains knowledge of the occurrence or the existence of a Default or Event of Default hereunder, notice of any and all such Defaults or Events of Default;

7.1.5 as soon as practicable, such other business or financial data, reports, or evaluations (whether or not prepared by the Borrower) as the Agent or the Banks may reasonably request.

7.1.6 as soon as practicable but in any event within sixty (60) days after the end of the fiscal quarter of Delta Galil (a) a statement of income and retained earnings of Delta Galil for such quarter, setting forth, in comparative form, budgeted figures for such quarter and actual figures for the corresponding quarter in the preceding fiscal year, and a balance sheet of Delta Galil as of the end of such quarter, setting forth, in comparative form, actual figures as at the end of the corresponding quarter in the preceding fiscal year, all in reasonable detail and certified as accurate by the Chief Executive Officer, Chief Financial Officer or Chief Operating Officer of Delta Galil, subject to changes resulting from normal year-end adjustments, and (b) an operating statement for Delta Galil for such quarter including, without limitation, statements of cash flow and analysis of working capital and other data as the Agent or the Banks may reasonably request, and a comparison of actual cash flow and working capital with budgeted amounts for such quarter;

7.1.7 as soon as practicable but in any event within sixty (60) days after the end of the Delta Galil's fiscal six (6) month period (a) statements of income and retained earnings of Delta Galil for such period, setting forth in comparative form, budgeted figures for such quarter and actual figures for the corresponding six (6) month period in the preceding fiscal year, and a balance sheet of Delta Galil as of end of such six (6) month period, setting forth, in comparative form, actual figures as at the end of the corresponding six (6) month period in the preceding fiscal year, all in reasonable detail, reviewed by independent public accounts selected by Delta Galil and satisfactory to the Agent, subject to changes resulting from normal year-end adjustments, and (b) an operating statement for Delta Galil for such six (6) month period including, without limitation, statements of cash flow and analysis of working capital and such other data as the Agent or the Banks may reasonably request, and a comparison of actual cash

flow and working capital with budgeted amounts for such period;

7.1.8 as soon as practicable but in any event within ninety (90) days after the end of each fiscal year, a statement of income, statement of profits and losses, retained earnings and changes in financial condition for Delta Galil for such year, and a balance sheet of Delta Galil as of the end of such year, all with supporting schedules setting forth in each case, in comparative form, corresponding figures for the period covered by the preceding annual audit and as of the end of the preceding fiscal year, certified by such nationally recognized firm of certified public accountants as has been selected by Delta Galil and is satisfactory to the Agent, whose opinion shall be unqualified and otherwise in scope and substance reasonably satisfactory to the Agent;

7.1.9 as soon as practicable, all periodic filings by Delta Galil with the United States Security and Exchange Commission and such other business or financial data, reports, evaluations or certificates of Delta Galil as the Agent may reasonably request.

All financial statements delivered to the Agent pursuant to Section 7.1.1 through 7.1.5 of this Agreement (except where otherwise expressly indicated) shall be prepared in accordance with GAAP, applied on a consistent basis (except as otherwise consented to by the Agent). Together with each delivery of statements of income, retained earnings, changes in financial condition and balance sheets required hereunder, the Borrower shall deliver to the Agent (i) an Officer's Certificate in substantially the form of "Exhibit I" annexed hereto, stating that (a) there exists no Default or Event of Default or, if any Default or Event of Default exists, specifying the nature thereof and the action the Borrower expect to take with respect thereto, and (b) no Material Adverse Effect has occurred with respect to any of the Loan Parties, (ii) a certificate that it is in compliance with the covenants set forth in Sections 8.18, 8.19 and 8.20 of this Agreement, together with a statement setting forth its calculations in making such determination, and (iii) with respect to such financial statements described in this Section 7.1, a certificate of the independent public accountant performing the audit that, in conducting the audit necessary to permit them to issue a report with respect to such financial statements, they have obtained no knowledge of the existence of a Default or Event of Default, or, if such accountants did obtain such knowledge, specifying the nature of the Default or Event of Default.

All financial statements delivered to the Agent pursuant to Section 7.1.6 through 7.1.9 of this Agreement shall be prepared in accordance with generally accepted accounting principals in Israel, applied on a consistent basis (except as otherwise consented to by the Agent).

**Section 7.2** **Inspection.** The Agent, or any Person designated by the Agent, shall have the right, from time to time hereafter, to call at each Loan Party's place or places of business (or any other place where the Collateral or any information relating thereto is kept or located) during reasonable business hours, without hindrance or delay, (i) to inspect, audit, check and make copies of and extracts from the applicable Loan Party's books, records, journals, orders, receipts, correspondence and other data relating to the Loan Party's business or to any transactions between the parties hereto and whether such item or data are maintained in accordance with such Loan Party's standard operating procedures or pursuant to this Agreement, (ii) to verify such matters concerning the Collateral as the Agent (in the Agent's sole and absolute discretion) may consider appropriate and (iii) to discuss the affairs, finances and business of the Loan Parties

with their officers and directors. Upon request, the Borrower shall provide the Agent with copies of such documents as the Agent may request. The Borrower shall deliver to the Agent, within three (3) Business Days of its request, any instruments necessary to obtain records from any Person maintaining the same. The Agent shall have the right, at any time or times after an Event of Default has occurred and is continuing, to verify by mail, telephone, telegraph or other communication with any Account Debtor, under any name and in any form, the validity, amount or any other matter relating to any or all of the Accounts. The Borrower shall pay on demand all expenses reasonably incurred by the Agent in acquiring information pursuant to this Section 7.2 including, but not limited to, appraisers and asset based lender review auditors.

**Section 7.3** **Conduct of Business.** If any change in the principal place of business and chief executive office or location of books and records of the Borrower from that shown in the preamble to this Agreement, or any change in the places where any Loan Party's Inventory or Equipment is located as permitted in Section 6.5 of this Agreement is to occur, the Borrower shall notify the Agent and the Banks thirty (30) days in advance thereof. Each Loan Party shall maintain in full force and effect its corporate existence, licenses, bonds, franchises, leases, patents, trademarks, contracts and other rights necessary to the profitable conduct of its business. Each Loan Party shall comply with any and all labor or employment related laws, statutes, rules and regulations of any governmental or quasi-government authority asserting jurisdiction for such transfer of business location. Each Loan Party shall continue in and limit its operations to the same general line or type of business as that presently conducted by it and shall comply in all material respects with all applicable laws and regulations of all federal, state or local governmental authorities. The Collateral shall remain, at all times, at the locations set forth in Schedule 6.5 of this Agreement and the Borrower shall not transfer the Collateral, books or records from such Premises to any other location without the prior written consent of the Agent, except in the ordinary course of business.

**Section 7.4** **Taxes.** Each Loan Party shall prepare and timely file all federal, state and local tax returns required to be filed by them and shall pay to the appropriate governmental authorities when due, all present and future Federal, state, local and other income and other taxes, including but not limited to sales taxes, payroll taxes and property taxes, together with interest thereon and penalties with respect thereto, if any, and any payment of principal, interest charges, fees or other amounts made on or in respect thereof to be paid or deposited by the applicable Loan Party ("Tax Liabilities"), except that such Loan Party may defer any such payment if it is diligently contesting such Tax Liabilities in good faith by appropriate proceedings, provided the taxpayer has maintained an adequate reserve according to GAAP, but any such deferment shall not extend beyond the time when such unpaid Tax Liabilities become a Lien upon any of such Loan Party's assets. Each Loan Party will furnish the Agent promptly after its request with evidence satisfactory to the Agent establishing payment of such Taxes. In the Required Lender's discretion, the Agent shall have the right (but shall not be obligated) to pay any Tax Liabilities in the event any Loan Party shall fail timely to do so, provided that the Agent provides the Borrower with not less than seven (7) days prior written notice of any such payment; any such payment shall be deemed an Advance hereunder bearing interest at the Prime Rate. After the provision by the Agent to the Borrower of official receipts evidencing such payments, the Borrower shall, promptly on demand, reimburse the Agent for any such payment and any costs and expenses (including reasonable attorneys' fees) which it or the Banks may

incur in connection therewith.

**Section 7.5 Insurance.** Each Loan Party shall at all times and at its expense maintain business interruption coverage, public liability, product liability and third party property insurance, and shall keep such of their tangible assets as constitute Collateral, Auburn Collateral, or Burren Collateral, as is applicable, insured against loss or damage by fire, theft, explosion and all other hazards and risks insured against by other owners or users of similar businesses in amounts at least equal to the lesser of (i) the outstanding principal balance of the Obligations, or (ii) the full replacement value of all such assets. All such policies of insurance shall (i) be in a form, in amounts and with insurers reasonably acceptable to the Agent, (ii) require at least thirty (30) days prior written notice to the Agent of termination or material alteration, (iii) name the Agent on behalf of each Bank as a lender, loss payee or additional insured, as the case may be, or be validly assigned to the Agent as agent for the Banks, in form and substance satisfactory to the Agent, and (iv) allow the Agent to pay any premiums therefor or deductibles thereunder for or on account of the applicable Loan Party. The Borrower shall deliver to the Agent certificates of such insurance and evidence of payment of all premiums therefor, quarterly statements which describe any and all claims in excess of \$100,000 made thereunder and, at least ten (10) days prior to the expiration of such policies, certificates of renewal. If any Loan Party, at any time or times hereafter, shall fail to obtain or maintain policies of insurance required hereunder, or to pay any premium in whole or in part relating thereto, the Agent may, without waiving or releasing any obligation of the applicable Loan or any Default or Event of Default hereunder, at any time or times thereafter (but shall be under no obligation to do so), obtain and maintain such policies of insurance and pay such premiums therefore and take any other action with respect thereto which the Agent deems advisable. The Borrower shall, promptly on demand, reimburse the Agent for any such payment and any costs or expenses (including reasonable attorneys fees) which it may incur in connection therewith.

**Section 7.6 Notice of Suit etc.** The Borrower shall, as soon as practicable but in any event within two (2) Business Days after the Borrower learns of any of the following, give written notice to the Agent of (i) any material proceeding instituted or threatened to be instituted, by or against any Loan Party in any federal, state, local or foreign court or before any commission or other regulatory body (federal, state, local or foreign), (ii) any violation of law, statute, regulation or ordinance which could reasonably be expected to have a Material Adverse Effect on any Loan Party and (iii) any material adverse change in business, assets or condition, financial or otherwise, of any Loan Party.

**Section 7.7 Preservation of Collateral and Perfection of Liens Therein.**

7.7.1 **Preservation of Collateral and Perfection of Liens.** The Borrower shall take such steps as are necessary to preserve the value of all Accounts, Inventory, Equipment, and other material properties owned by any of the Loan Parties or used by them in their businesses, ordinary wear and tear excepted. The Borrower shall execute and deliver to the Agent for the benefit of the Banks, concurrently with the execution of this Agreement and at any time or times hereafter, any and all instruments, documents, conveyances, assignments, mortgages, security agreements, financing statements or other Loan Documents (and shall pay the cost of filing or recording the same in all offices deemed necessary by the Agent) as the Agent in its sole and

absolute discretion may request and in form and substance satisfactory to it, to perfect and keep perfected the Liens in the Collateral granted by the Borrower, and the Auburn Collateral and Burlen Collateral granted respectively by Auburn and Burlen to the Banks, to otherwise protect or preserve such collateral and Banks' Lien therein, or to enforce such Lien in such collateral or to create or perfect a Lien in the Banks' favor in any other assets or property now owned or hereafter acquired by any Loan Party.

7.7.2 Maintain Equipment. The Borrower shall, and shall cause Auburn and Burlen to, keep and maintain the Equipment useful and reasonably necessary to such Loan Party's business in good operating condition and repair, ordinary wear and tear excepted, and shall make all necessary replacements thereof so that the value and operating efficiency thereof shall at all times be maintained and preserved in accordance with industry standards, shall promptly inform Agent of any additions to or deletions from the Equipment; and shall not permit any such Equipment to become a fixture to real estate or an accession to other personal property. The Borrower shall, immediately upon demand, deliver to the Agent any and all evidences and indices of ownership of any of the Equipment (including, but not limited to, certificates of title and applications for title).

7.7.3 Intellectual Property. The Borrower, within ten (10) days thereafter, shall notify the Agent of any property which any Loan Party has acquired which should be listed on Schedule 6.11 hereto, and will do and perform such acts as the Agent shall reasonably require to grant the Banks a security interest therein. The Borrower may cause Auburn to obtain and deliver to the Agent a written consent from Converse, Inc. authorizing the Agent upon the occurrence of an Event of Default, to exercise its right of sale of Inventory bearing the trademarks licensed by Converse, Inc. to Auburn. If such consent is not received by the Agent, not more than \$1,000,000 of such licensed Inventory shall be included in the Borrowing Base.

## **Section 7.8   Reports**

7.8.1 Monthly Reports. The Borrower shall deliver to the Agent, no later than the fifteenth (15<sup>th</sup>) calendar day of each month, a written report, which shall include, as of the last Business Day of the preceding month, the following, in form reasonably satisfactory to the Agent:

7.8.1.1 a detailed aged trial balance of Accounts;

7.8.1.2 an accounts payable aging; and

7.8.1.3 a Borrowing Base Certificate in the form annexed hereto as Exhibit J certified by the President or Chief Financial Officer of the Borrower.

The monthly reports shall also include such additional information as the Agent shall from time to time require. Upon request therefor by the Agent, the Borrower shall furnish copies of any reports or information, in form satisfactory to the Agent, concerning assets, liabilities and collateral as the Agent may reasonably require.

7.8.2 **Additional Reports.** Upon the reasonable request of any Bank, the Borrower shall deliver to the Banks within the time periods reasonably requested by such Bank such further schedules, information and/or documents as each Bank may reasonably require. The items to be provided under this subsection are to be in form and scope satisfactory to the requesting Bank, and provided to all of the Banks.

**Section 7.9 Comply with Laws.** Each Loan Party shall comply in all material respects with all applicable laws and regulations with respect to its properties and business, including such laws and regulations as are hereafter enacted or promulgated by any governmental authority having jurisdiction over it or any of its properties.

**Section 7.10 Pay all Indebtedness.** Each Loan Party shall pay all Indebtedness and obligations, secured and unsecured, promptly in accordance with their terms and promptly pay and discharge or cause to be paid and discharged all license fees, assessments and governmental charges or levies imposed upon it or upon its income and profits or upon its properties, or upon any part thereof, respectively, before the same shall become in default, as well as all lawful claims for labor, materials and supplies or otherwise which, if unpaid, might become a lien or charge upon its properties, or any part thereof, provided that they shall not be required to pay and discharge or cause to be paid and discharged any such assessment, charge, levy or claim so long as the validity thereof shall be contested in good faith by appropriate proceedings and they shall have set aside on their books adequate reserves with respect to any such assessment, levy or claim so contested in accordance with GAAP.

**Section 7.11 Collateral Audit, etc.** Upon any Bank's request and at the Borrower's expense, (i) not more than two (2) times per calendar year (unless an Event of Default has occurred whereupon there shall be no limit, provided, however, that if the Event of Default has been cured or waived, an additional audit may be conducted at the Borrower's expense within three (3) months thereafter) the Agent shall retain an auditor, to examine, prepare and complete an audit and/or valuation of all or any of the Collateral, Auburn Collateral or Burlen Collateral, which the Agent may use in determining the Borrowing Base or for any other purpose, and which shall otherwise be in form and substance satisfactory to the Agent, and (ii) not more often than one (1) time per annum the Agent may retain an appraiser to prepare an appraisal and valuation of all or any of the Real Estate Assets, and at the Agent's option, an environmental assessment and report with respect thereto.

**Section 7.12 Proceeds of Loans.** The proceeds of the Loans will be (i) used by the Borrower for (a) its working capital, and (b) up to \$65,000,000 used to fund the Borrower's purchase of the Burlen Shares, (ii) loaned to Burlen to satisfy its Indebtedness to Bank of America and (iii) loaned to or invested in Auburn or Burlen for use as working capital, and for no other purpose.

**Section 7.13 Environmental Laws.** Each Loan Party shall conduct its business and control its use of any of the Premises so as to comply in all material respects with Environmental Law and all Environmental Permits obtained thereunder, including without limitation, the Federal Resource Conservation and Recovery Act, the Federal Comprehensive Environmental Response, Compensation and Liability Act, the Federal Clean Water Act, the Federal Clean Air

Act and the Federal Occupational Safety and Health Act and all state counterparts thereof and to avoid the occurrence of any Release or threatened Release, in amounts in violation of any Environmental Law, any Environmental Complaint and the creation of any liability under Environmental Law concerning the Loan Parties, their Affiliates, their business or any of the Premises; provided, however, that nothing contained in this Section 7.13 shall prevent any Loan Party from contesting, in good faith and by appropriate legal proceedings, any such law, regulation or interpretation or application thereof. If a Loan Party shall receive notice that any violation of any Environmental Law may or is alleged to have been committed or is about to be committed by it, or in the case of the Borrower by Auburn or Burlen or any past or then present tenant, user, owner, operator or any other Person, on, at or about the Premises, or that any Loan Party or Bank has or may have any liability or obligations under any Environmental Law or by reason of any Release or threatened Release in amounts in violation of any Environmental Law, the Borrower agrees that it shall, at its own expense and subject to the contract rights set forth above, immediately cure, or if appropriate cause Auburn or Burlen, as is appropriate to cure, the same and indemnify, protect, defend and hold the Banks and their officers, directors, employees, attorneys, and agents harmless from any and every liability, loss, damage, responsibility, obligation action, judgment, suit, claim, and expense (including reasonable attorney's fees and all reasonable expenses incurred by reason of such or by reason of any action to enforce this Section 7.13 as well as fines, penalties, cleanup costs, disbursements, investigation costs and consultants fees) in respect thereof.

**Section 7.14 Notice of Release or Environmental Complaint.** The Borrower shall promptly give to the Agent oral and written notice of the occurrence of any Release in amounts in violation of any Environmental Law or Environmental Complaint. Such notices shall include, among other information, the name of the Person who filed or made the claim, the nature of the claim, the actual or potential amount of the claim, a detailed description of the events, Release or Environmental Complaint and the Loan Party's plan for dealing with same. The Borrower shall promptly comply, or cause Auburn or Burlen, as may be applicable, to comply with its obligations under all laws and regulations with regard to such Release or Environmental Complaint.

**Section 7.15 Additional Collateral.** Promptly advise the Banks as to (i) the acquisition by any Loan Party of any interest in any real estate, and all the particulars thereof, and if requested by the Agent (which shall make such a request, if so directed by the Required Lenders) assist the Agent for the benefit of the Banks in obtaining a first priority Lien thereon, and (ii) any new address where any of the Collateral, Auburn Collateral or Burlen Collateral may be located.

**Section 7.16 Execution of Supplemental Instruments.** Execute and deliver to the Agent from time to time, upon demand, such supplemental agreements, statements, assignments and transfers, or instructions or documents relating to the Collateral, the Auburn Collateral or the Burlen Collateral and such other instruments as the Agent may reasonably request, in order that the full intent of this Agreement may be carried into effect.

**Section 7.17 Operating Accounts.** The Borrower shall maintain all of its operating accounts and cash management arrangements with any of the Banks and, as soon as is practical,

but in any event prior to February 1, 2005, cause each of Auburn and Burlen to (i) take such action as is necessary to cause all of its operating and cash management accounts to be maintained at any of the Banks, and to provide the Agent with such evidence as the Agent may reasonably require to establish Auburn's and Burlen's compliance with this covenant, or (ii) execute, and have each bank where such accounts are maintained execute, such blocked account, and other agreements, with respect to such account as the Agent shall reasonably require.

**Section 7.18 Executives.** Each of the Loan Parties shall continue to employ its Chief Executive Officer in the same capacity, and with substantially the same duties, as such Person holds on the Closing Date; provided, however, that if any such Person leaves the employ of the applicable Loan Party for any reason, the Borrower (i) within ten (10) Business Days thereafter shall give the Agent notice thereof, and (ii) within ninety (90) Business Days shall have filled the vacated position with a Person reasonably satisfactory to the Agent.

**Section 7.19 Wundies, Inc.** Within forty-five (45) days of the Closing Date, the Borrower shall cause Wundies, Inc, a New York corporation, to be dissolved, and shall provide the Agent with evidence thereof.

## **ARTICLE 8**

### **NEGATIVE COVENANTS**

The Borrower agrees that without the prior written consent of the Required Lenders, except with respect to Sections 8.3, 8.5, 8.10, 8.15 where the consent of all of the Banks shall be required.

**Section 8.1 Liens.** No Loan Party shall create, incur, assume or suffer to exist any Lien on any of their assets, including, without limitation, the Collateral except (i) Permitted Encumbrances (ii) Liens on Equipment hereafter leased or acquired by a Loan Party, provided that (a) such Liens secure Capitalized Lease Obligations or other Indebtedness permitted by clause (vii) of Section 8.2 of this Agreement and (b) such Liens do not apply to any other property or assets of the applicable Loan Party; or (iii) against the Real Estate Assets as contemplated by Sections 3.1 and 5.4 of this Agreement and listed on Schedule 8.1 annexed hereto.

**Section 8.2 Indebtedness.** The Borrower shall not, and shall not permit Auburn or Burlen to, incur, create, assume or become in any manner liable with respect to, or permit to exist, any Indebtedness except:

- (i) the Obligations;
- (ii) Indebtedness for capital expenditures as permitted pursuant to Section 8.8 of this Agreement;
- (iii) Indebtedness existing on the Closing Date as described or referred to in Schedule 8.2 annexed hereto;



(iv) unsecured short-term trade obligations of the Borrower and other accrued liabilities incurred, currently payable and paid in the ordinary course of its business;

(v) endorsements of instruments for deposit or collection in the ordinary course of business;

(vi) taxes accrued but not yet due and payable, or being contested in good faith as permitted by Section 7.4 of this Agreement;

(vii) obligations arising under long term pension plans subject to ERISA; and

(viii) Indebtedness in the aggregate amount not to exceed \$4,753,200, to Bank of America, fully secured by cash collateral in amount equal thereto, which Indebtedness shall be fully discharged on or before February 28, 2005.

(ix) intercompany Indebtedness, as permitted by Section 8.7 (iii) of this Agreement.

**Section 8.3 Consolidations, Mergers or Acquisitions.** The Borrower shall not, and shall not permit Auburn or Burlen, to recapitalize, consolidate or merge with or otherwise acquire all or substantially all of the assets or properties of any Person without the express written consent of each Bank.

**Section 8.4 Guaranties.** No Loan Party shall guarantee, endorse or otherwise in any way become directly or contingently liable for or in connection with the obligations of any other Person, except (i) endorsements of negotiable instruments for collection in the ordinary course of business (ii) guarantees made in the ordinary course of business up to an aggregate amount of \$250,000 outstanding at any time, and (iii) guaranties in favor of the Banks entered into in connection with this Agreement.

**Section 8.5 Disposal of Property.** No Loan Party shall sell, lease, transfer or otherwise dispose of any of properties, assets (whether tangible or intangible) or rights, except (i) sales of Inventory to customers in the ordinary course of business, and (ii) sales of obsolete or surplus Equipment.

**Section 8.6 Investments.** No Loan Party shall purchase or acquire obligations or stock of, or any other interest in, any Person, except (i) obligations issued or guaranteed by the United States of America or any agency thereof (ii) commercial paper with maturities of not more than 180 days and a published rating of not less than A-1 or P-1 (or the equivalent rating), (iii) certificates of time deposit and bankers' acceptances having maturities of not more than 180 days and repurchase agreements backed by United States government securities of a commercial bank if (A) such bank is a Bank or (B) has a combined capital and surplus of at least \$500,000,000, or (C) its debt obligations, or those of a holding company of which it is a subsidiary, are rated not less than A (or the equivalent rating) by a nationally recognized investment rating agency, and (iv) U.S. money market funds that invest solely in obligations

issued or guaranteed by the United States of America or an agency thereof.

**Section 8.7** **Loans.** No Loan Party shall make advances, loans or extensions of credit to any Person, except with respect to (i) the extension of commercial trade credit in connection with the sale of Inventory in the ordinary course of its business; (ii) loans to its employees in the ordinary course of business not to exceed the aggregate amount of \$75,000 at any time outstanding; and (iii) intercompany loans and advances or extensions of credit to or from the Borrower, Auburn, Burlen or Delta Galil.

**Section 8.8** **Capital Expenditures.** The Borrower shall not, and shall not permit Auburn or Burlen to, contract for, purchase or make any expenditure or commitments for fixed or capital assets (including capitalized leases) in 2005 in an amount in excess of (a) \$1,500,000 plus (b) \$2,500,000 for roof repairs by Burlen in the aggregate for all of the Loan Parties and in any subsequent fiscal year reporting period of the Borrower in an amount in excess of \$1,500,000 in the aggregate for all of the Loan Parties.

**Section 8.9** **Dividends.** The Borrower shall not declare pay or make any dividend or distribution on any shares of the common stock or preferred stock of the Borrower (other than dividends or distributions payable in its stock, or split-ups or reclassifications of its stock) or apply any of its funds, property or assets to the purchase, redemption or other retirement of any common or preferred stock, or of any options to purchase or acquire any such shares of common or preferred stock of the Borrower, unless it shall have received the prior written consent of the Agent.

**Section 8.10** **Nature of Business.** No Loan Party shall substantially change the nature of the business in which it is presently engaged, nor, purchase or invest, directly or indirectly, in any material assets or property other than in the ordinary course of business for assets or property which are useful in, necessary for and are to be used in its business as presently conducted.

**Section 8.11** **Transactions with Affiliates.** No Loan Party shall directly or indirectly, purchase, acquire or lease any property from, or sell, transfer or lease any property to, or otherwise deal with, any Affiliate, except transactions disclosed in the ordinary course of business, on an arm's-length basis on terms not less favorable than terms which would have been obtainable from a Person other than an Affiliate.

**Section 8.12** **Leases.** No Loan Party shall, as lessee, enter into any lease arrangement for real or personal property (unless capitalized and permitted under Section 8.8 hereof) if after giving effect thereto, aggregate annual rental payments for all Loan Parties for all leased property would exceed \$1,600,000 in any one fiscal year.

**Section 8.13** **Subsidiaries and Guarantors.** No Loan Party shall (i) form any subsidiary unless (a) such subsidiary (A) expressly joins in this Agreement as a Borrower and becomes jointly and severally liable for the Obligations of the Borrower hereunder, under each Note, and under any of the Loan Documents between the Borrower and either Bank, or (B) executes a guaranty, satisfactory in form and substance to the Agent, and if requested grant the Agent a security interest in its assets, in each case for the benefit of the Banks and (b) the Agent

shall have received all documents, including legal opinions, it may reasonably require, including but not limited to compliance with each of the foregoing conditions, (ii) enter into any partnership, joint venture or similar arrangement, other than in the ordinary course of business, without the prior written consent of the Banks, or (iii) issue any shares of their stock, unless in the case of Auburn and Burlen the certificates evidencing such shares, together with stock powers sufficient to permit the transfer of such shares upon delivery, are delivered to the Agent as collateral under the Pledge Agreement.

**Section 8.14 Compliance with ERISA.** The Borrower shall not (i) (a) maintain, or permit any Affiliate to maintain, or (b) become obligated to contribute, or permit any Affiliate to become obligated to contribute, to any Plan, other than those Plans disclosed on Schedule 8.14 annexed hereto, (ii) engage or permit any Affiliate to engage, in any non-exempt “prohibited transaction”, as that term is defined in Section 406 of ERISA and Section 4975 of the Code, (iii) incur, or permit any Affiliate to incur, any “accumulated funding deficiency”, as that term is defined in Section 302 of ERISA or Section 412 of the Code, (iv) terminate, or permit any Affiliate to terminate, any Plan where such event could result in any liability of the Borrower or any Affiliate or the imposition of a lien on the property of the Borrower or any Affiliate pursuant to Section 4068 of ERISA, (v) assume or permit any Affiliate to assume, any obligation to contribute to any Multiemployer Plan, (vi) incur, or permit any Affiliate to incur, any withdrawal liability to any Multiemployer Plan; (vii) fail promptly to notify the Agent of the occurrence of any “termination event” as defined under ERISA (viii) fail to comply with the requirements of ERISA or the Code or other applicable laws in respect of any Plan, (ix) fail to meet, or permit any member of the Affiliate to fail to meet, all minimum funding requirements under ERISA or the Code or postpone or delay or allow any Affiliate to postpone or delay any funding requirement with respect to any Plan.

**Section 8.15 Amendment of Certificate of Incorporation or By-Laws.** The Borrower shall not, and shall not permit Auburn or Burlen to, amend its Certificate of Incorporation or By-Laws without the prior written consent of the Banks, except that no consent need be obtained for ministerial technical changes (i.e. change of agent or address for service of process), but in the event of any such change, the Borrower shall deliver true and complete copies of the revised documents to the Agent, and the Agent shall provide the Banks with the copies.

**Section 8.16 Change Fiscal Year.** No Loan Party shall change (i) its fiscal year, (ii) its accounting treatment and reporting practices except as required by GAAP or (iii) its tax reporting treatment except (a) as required by law, and (b) Burlen shall make an election under Section 332(h) of the Internal Revenue Code to change its tax status from an “S” corporation to a “C” corporation.

**Section 8.17 Prepayment of Indebtedness.** No Loan Party shall prepay any Indebtedness other than in the case of the Borrower Indebtedness to the Banks as, and to the extent, permitted pursuant to this Agreement, except for certain Industrial Revenue Bonds referred to on Schedule 8.2.

**Section 8.18 Fixed Charge Coverage** The Borrower shall not permit the ratio of its (i)

EBITDA<sup>1</sup>, to (ii) Fixed Charges, for each twelve (12) month period ending as set forth below, to be less than the ratio set forth below for the corresponding period set forth below. Compliance with this covenant shall be measured on a quarterly basis for a rolling twelve (12) month period.

<u>Period</u>	<u>Ratio</u>
For the twelve (12) month period ending June 30, 2005	1.05 to 1.0
For the twelve (12) month period ending September 30, 2005	1.05 to 1.0
For the twelve (12) month period ending December 31, 2005	1.15 to 1.0
For the twelve (12) month period ending March 31, 2006	1.25 to 1.0
For the twelve (12) month period ending June 30, 2006	1.25 to 1.0
For the twelve (12) month period ending September 30, 2006	1.3 to 1.0
For the twelve (12) month period ending December 31, 2006	1.3 to 1.0
For the twelve (12) month period ending March 31, 2007	1.5 to 1.0
For the twelve (12) month period ending June 30, 2007	1.5 to 1.0
For the twelve (12) month period ending September 30, 2007	1.5 to 1.0
For the twelve (12) month period ending December 31, 2007	1.5 to 1.0
For the twelve (12) month period ending March 31, 2008	1.6 to 1.0
For the twelve (12) month period ending June 30, 2008	1.6 to 1.0
For the twelve (12) month period ending September 30, 2008	1.6 to 1.0
For the twelve (12) month period ending December 31, 2008	1.6 to 1.0
For the twelve (12) month period ending March 31, 2009	1.6 to 1.0
For the twelve (12) month period ending June 30, 2009	1.6 to 1.0
For the twelve (12) month period ending September 30, 2009	1.6 to 1.0
For the twelve (12) month period ending December 31, 2009	1.6 to 1.0

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<sup>1</sup> For the purpose of this covenant, and the covenants provided in Sections 8.19 and 8.20, if there is any material change in GAAP which would result in a breach, the Banks, in good faith, will consider appropriate revisions to the covenants.

**Section 8.19 Net Worth Ratio.** The Borrower shall not permit the ratio of its (i) Net Worth consolidated (without duplication) with the Net Worth of the other Loan Parties, to (ii) its Total Assets consolidated (without duplication) with the Total Assets of the other Loan Parties for each period set forth below, to be less than the ratio set forth below for the corresponding period set forth below. Compliance with this covenant shall be measured on a quarterly basis for a rolling twelve (12) month period.

<u>Period</u>	<u>Ratio</u>
For the twelve (12) month period ending June 30, 2005	0.2 to 1.0
For the twelve (12) month period ending September 30, 2005	0.2 to 1.0
For the twelve (12) month period ending December 31, 2005	0.2 to 1.0
For the twelve (12) month period ending March 31, 2006	0.25 to 1.0
For the twelve (12) month period ending June 30, 2006	0.25 to 1.0
For the twelve (12) month period ending September 30, 2006	0.3 to 1.0
For the twelve (12) month period ending December 31, 2006	0.3 to 1.0
For the twelve (12) month period ending March 31, 2007	0.4 to 1.0
For the twelve (12) month period ending June 30, 2007	0.4 to 1.0
For the twelve (12) month period ending September 30, 2007	0.4 to 1.0
For the twelve (12) month period ending December 31, 2007	0.4 to 1.0
For the twelve (12) month period ending March 31, 2008	0.4 to 1.0
For the twelve (12) month period ending June 30, 2008	0.4 to 1.0
For the twelve (12) month period ending September 30, 2008	0.4 to 1.0
For the twelve (12) month period ending December 31, 2008	0.4 to 1.0
For the twelve (12) month period ending March 31, 2009	0.4 to 1.0
For the twelve (12) month period ending June 30, 2009	0.4 to 1.0
For the twelve (12) month period ending September 30, 2009	0.4 to 1.0

For the twelve (12) month period ending December 31, 2009 0.4 to 1.0

**Section 8.20 Leverage Ratio.** The Borrower shall not permit the ratio of: (i) the sum of its (a) Loans (b) Letters of Credit, and (c) Acceptances at the end of each period set forth below, to EBITDA be higher than the ratio set forth below for the corresponding period. Compliance with this covenant shall be measured on a quarterly basis for a rolling twelve (12) month period.

<u>Period</u>	<u>Ratio</u>
For the twelve (12) month period ending June 30, 2005	5.0 to 1.0
For the twelve (12) month period ending September 30, 2005	5.0 to 1.0
For the twelve (12) month period ending December 31, 2005	4.5 to 1.0
For the twelve (12) month period ending March 31, 2006	4.0 to 1.0
For the twelve (12) month period ending June 30, 2006	4.0 to 1.0
For the twelve (12) month period ending September 30, 2006	4.0 to 1.0
For the twelve (12) month period ending December 31, 2006	4.0 to 1.0
For the twelve (12) month period ending March 31, 2007	3.5 to 1.0
For the twelve (12) month period ending June 30, 2007	3.5 to 1.0
For the twelve (12) month period ending September 30, 2007	3.5 to 1.0
For the twelve (12) month period ending December 31, 2007	3.5 to 1.0
For the twelve (12) month period ending March 31, 2008	3.0 to 1.0
For the twelve (12) month period ending June 30, 2008	3.0 to 1.0
For the twelve (12) month period ending September 30, 2008	3.0 to 1.0
For the twelve (12) month period ending December 31, 2008	3.0 to 1.0
For the twelve (12) month period ending March 31, 2009	3.0 to 1.0
For the twelve (12) month period ending June 30, 2009	3.0 to 1.0
For the twelve (12) month period ending September 30, 2009	3.0 to 1.0

For the twelve (12) month period ending December 31, 2009 3.0 to 1.0

**Section 8.21 Delta Galil Debt.** The Borrower shall make no payments of principal, or interest at a rate which exceeds the Term Loan Rate, on its Indebtedness to Delta Galil in the principal amount of \$10,000,000 nor shall the Borrower agree to or make payments of interest on any other or future Indebtedness to Delta Galil at an interest rate which exceeds the Term Loan Rate.

## **ARTICLE 9**

### **EVENTS OF DEFAULT**

**Section 9.1 Events of Default.** Each of the following events, whether or not caused by or within the control of the Borrower, shall constitute an event of default (an “Event of Default”) under this Agreement:

9.1.1 **Failure to Make Payments When Due.** The Borrower or any Guarantor shall fail to pay any payments of principal or interest or any other Obligations when due whether on the due date thereof or any time fixed for prepayment or by acceleration thereof or otherwise.

9.1.2 **Breach of Covenants.** The Borrower or any Guarantor shall fail or neglect duly and punctually to perform, comply with or observe any of its covenants, obligations or agreements (i) described in Article 8; or (ii) described in any other Loan Document or any other provision of this Agreement not otherwise referred to in this Section 9.1 and the same is not cured within five (5) Business Days after written notice thereof shall have been given to the Borrower or the applicable Guarantor by the Agent.

9.1.3 **Breach of Warranty.** Any representation or warranty now or hereafter made or deemed made by the Borrower in this Agreement, or the Borrower or any Guarantor in any of the other Loan Documents or any certificate, report or other document furnished in connection with this Agreement, is untrue or incorrect in any material respect when made.

9.1.4 **Judgments, Liens.** A judgment or judgments in the aggregate shall be entered against the Borrower or a Guarantor in an amount (as to the Borrower and all Guarantors) which is in excess of \$250,000 (excluding the Burlen Judgment Lien) and such judgment shall not be satisfied, fully bonded, discharged or vacated and shall remain in effect for thirty (30) consecutive days without a stay of enforcement or execution, or a nonconsensual Lien which is not a Permitted Encumbrance shall be filed against any Collateral or property of the Borrower or a Guarantor and which shall not be fully bonded, vacated, discharged or released with forty-five (45) days of the date of filing.

9.1.5 **Attachment.** All or any material part of the Collateral, the Auburn Collateral or the Burlen Collateral is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes within the possession of any receiver, trustee, custodian or assignee for the benefit of creditors and such attachment is not vacated within thirty (30) days.

9.1.6 Bankruptcy; Appointment of Receiver.

9.1.6.1 An involuntary proceeding shall be commenced against the Borrower or a Guarantor under any applicable bankruptcy, insolvency, reorganization, receivership, arrangement or readjustment of debt or other similar law now or hereinafter in effect, which proceeding is not dismissed, stayed or vacated within thirty (30) days thereafter; or a decree or order of a court having jurisdiction for the appointment of a receiver, liquidator, administrator, trustee, custodian or other officer having similar powers over the Borrower or a Guarantor or over all or a substantial part of the property of the Borrower or a Guarantor shall have been entered; or an interim receiver, trustee or other custodian of the Borrower or a Guarantor or of all or a substantial part of the property of the Borrower or a Guarantor shall have been appointed or a warrant of attachment, execution or similar process against any substantial part of the property of the Borrower or any Guarantor shall have been issued, and in any such event not been stayed, dismissed, bonded or discharged within thirty (30) days of entry, appointment or issuance.

9.1.6.2 The Borrower or a Guarantor shall permit, or acquiesce in, an order for relief entered with respect to it under, or shall commence a voluntary case or proceeding under, any applicable bankruptcy, insolvency or other similar law now or hereafter in effect; or shall consent to the entry of an order for relief in an involuntary proceeding or to the conversion of an involuntary proceeding to a voluntary proceeding, under any such law; or shall consent to the appointment of or taking possession by a receiver, trustee or other custodian for all or a substantial part of its property; or the Borrower or a Guarantor shall make any assignment for the benefit of creditors or shall be unable or fail, or admit in writing its inability, to pay its debts as such debts become due; or the Borrower or any Guarantor or any of their respective Boards of Directors takes any corporate action to authorize any of the foregoing.

9.1.7 Other Loan Documents. A default or event of default shall have occurred under any of the other Loan Documents beyond any grace or cure period permitted therein.

9.1.8 Injunction. The Borrower or any Guarantor is enjoined, restrained, or in any way prevented by order of any court or any administrative or regulatory agency from conducting all or any material part of its business affairs and such order is not lifted or stayed within ten (10) Business Days.

9.1.9 Default Under Other Agreements. A breach by the Borrower or any Guarantor shall occur under any other agreement, document or instrument (other than an agreement, document or instrument evidencing the lending of money by such party), whether heretofore, now or hereafter existing between the Borrower or any Guarantor and any Person which breach causes a Material Adverse Effect and such breach continues for more than five (5) Business Days beyond any applicable grace period.

9.1.10 Default as to Other Indebtedness. The Borrower or any Guarantor shall fail to make any payment due on any obligation in respect of any Indebtedness or any guaranty of such Indebtedness having an outstanding principal amount in excess of \$100,000, and shall fail to cure such default within any applicable grace period, or any other breach, default or event of default, however defined, shall occur under any instrument, agreement or indenture which shall cause an



Indebtedness in excess of \$100,000 to be accelerated or immediately due and payable.

9.1.11 Material Adverse Change. An adverse change deemed material by the Banks, in the exercise of their sole, absolute and reasonable discretion, in the business, properties, management, operations, methodology or system of financial reporting, or financial condition of the Borrower or any Guarantor shall occur.

9.1.12 Ownership of the Borrower. There shall occur a change in the ownership of the Borrower or any Guarantor other than Delta Galil, such that Delta Galil shall directly or indirectly fail to own and control one hundred (100%) percent, on a fully diluted basis, of the outstanding voting stock of the Borrower and each such Guarantor.

9.1.13 Loss of Collateral. There shall occur the loss, theft, substantial damage to or destruction of any portion of the Collateral, the Auburn Collateral, the Burlen Collateral or Real Estate Assets, not fully covered by insurance, which by itself or with other such losses, thefts, damages or destruction of the Collateral, the Auburn Collateral, or Burlen Collateral shall materially impair the operations of any Loan Party, or there shall occur the exercise of the right of condemnation or eminent domain or any portion of the Collateral, the Auburn Collateral or the Burlen Collateral which by itself or with other such exercises of the right of condemnation or eminent domain shall materially impair the operations of any Loan Party.

9.1.14 Environmental Lien. If any governmental or quasi-governmental Person asserts or creates a Lien in an amount in excess of \$50,000 upon any or all of the assets, equipment, property, or other facilities of the Borrower by reason of the occurrence of a Release in an amount in violation of any Environmental Law or Environmental Complaint, which shall not be fully bonded, vacated, discharged or released within thirty (30) days of the date of filing.

9.1.15 Unenforceability of Any Loan Document. This Agreement or any of the other Loan Documents shall for any reason cease to be, or be asserted by the Borrower or a Guarantor or any other Person not to be legal, valid or enforceable in accordance with its terms, or the security interest or lien purported to be created by any of the Loan Documents shall for any reason cease to be, or be asserted by the Borrower or a Guarantor, not to be, a valid, first priority perfected security interest in any Collateral (except to the extent otherwise permitted under this Agreement or any of the Loan Documents).

9.1.16 Delta Galil Material Adverse Effect. One or more circumstance or events, financial or otherwise, shall occur which in the opinion of the Banks would have a Material Adverse Effect on Delta Galil; including but not limited to a failure to meet any financial obligation to any of the Banks or any of their Affiliates.

9.1.17 Delta Galil Guarantees. Either of the Delta Galil Guarantees shall be terminated or be unenforceable.

9.1.18 Walmart Sales. The aggregate sales of Inventory by the Loan Parties to Walmart, Inc. shall be less than \$100,000,000 in any fiscal year of the Borrower.

9.1.19 Conditions Subsequent. Any of the conditions subsequent set forth in Sections 3.2, and 3.3 and 3.4 of this Agreement shall not be satisfied within the time periods provided therein.

## **ARTICLE 10**

### **RIGHTS AND REMEDIES**

**Section 10.1 Acceleration; Termination**. If an Event of Default has occurred, and at any time thereafter while it is continuing, the Agent upon receipt of instructions from the Required Lenders shall, if so requested by the Required Lenders (a) terminate the obligation to lend and (b), without limiting the ability to do so at any other times, the Agent on behalf of the Banks upon receipt of instructions from the Required Lenders shall demand payment of the Obligations, and thereupon the Obligations shall become due and payable immediately and the Agent and the Banks' obligations under this Agreement shall terminate, provided, however, that if an Event of Default specified in Section 9.1.6 of this Agreement occurs, the Obligations shall automatically become due and payable immediately, without presentment, demand, protest or notice of any kind, all of which are hereby expressly waived by the Borrower, and the Banks' obligations under this Agreement shall automatically terminate immediately, without any notice or demand.

Under all circumstances, the Agent and the Banks' rights and remedies throughout this Article 10 under this Agreement and any other Loan Documents shall survive any termination of its obligation to lend until all of the Obligations under this Agreement or any other Loan Documents have been fully and finally paid. Without limiting the generality of the foregoing, notwithstanding any termination of this Agreement, until all of the Obligations shall have been fully and finally paid and satisfied, the Banks shall retain their security interest in and to all of the Collateral, the Auburn Collateral and the Burlen Collateral, and the Borrower shall continue to remit collections of Accounts and proceeds as provided herein.

Each Event of Default under this Agreement shall be deemed continuing until it is waived in writing by, or cured to the satisfaction of the Banks, which is evidenced by a written statement signed by an authorized officer of the Agent that such Event of Default has been satisfied.

**Section 10.2 Rights and Remedies Generally**. Upon the occurrence of an Event of Default, the Agent on its behalf and on behalf of each Bank shall have, in addition to any other rights and remedies contained in this Agreement or in any of the other Loan Documents, all of the rights and remedies of a secured party under the Uniform Commercial Code or other applicable laws, all of which rights and remedies shall be cumulative, and non-exclusive, to the extent permitted by law.

**Section 10.3 Entry Upon Premises and Access to Information**. Upon the occurrence and during the continuation of an Event of Default, the Agent shall have the right to enter upon any premises (without any obligation to pay rent to the Borrower, Auburn or Burlen) where the Collateral, the Auburn Collateral or the Burlen Collateral is located (or where the Agent believes it to be located) or any other place or places where the Collateral, the Auburn Collateral or the

Burlen Collateral is located (or where the Agent believes it to be located) and to remove the Collateral, the Auburn Collateral, or the Burlen Collateral therefrom for such time as the Agent may desire in order to collect or liquidate the Collateral, the Auburn Collateral or the Burlen Collateral. In lieu of or in addition to the foregoing, the Agent may require the applicable Loan Party to assemble the Collateral, the Auburn Collateral or the Burlen Collateral and make it available to the Agent at a place or places to be designated by the Agent. Upon the occurrence and during the continuation of an Event of Default, the Agent shall have the right to obtain access to each Loan Party's data processing equipment, computer hardware and software relating to or containing information regarding the Collateral, the Auburn Collateral or the Burlen Collateral and to use all of the foregoing and the information contained therein in any manner the Agent reasonably deems appropriate.

#### **Section 10.4 Disposition of Collateral by Agent.**

10.4.1 Manner of Disposition. Any sale, lease or other disposition by the Agent of the Collateral, the Auburn Collateral or the Burlen Collateral, or any part thereof, after the occurrence of and during the continuation of an Event of Default may be for cash or other value in any number of lots at public or private sale, and the Agent or any Bank may purchase all or any part of the Collateral, the Auburn Collateral or the Burlen Collateral, at public or, if permitted by law, private sale and in lieu of actual payment of such purchase price may set off the amount of such purchase price against the Obligations. Any sales of the Collateral, the Auburn Collateral or the Burlen Collateral may be adjourned from time to time with or without notice. The Agent may, in its sole and absolute discretion, cause the Collateral, the Auburn Collateral or the Burlen Collateral, as is applicable, to remain on the Borrower's, Auburn's or Burlen's premises, as applicable, at the Borrower's expense, pending sale or other disposition thereof. The Agent shall have the right to conduct such sales on the Borrower's, Auburn's or Burlen's premises or elsewhere, at the Borrower's expense, on such occasion or occasions as the Agent may see fit. The Borrower shall, and shall cause each of Auburn and Burlen to, execute and deliver, or cause to be executed and delivered, such instruments, document assignments, deeds, waivers, certificates and affidavits and take such further action as the Agent shall require in connection with respect to such sale. Any notice required by law to be given by the Agent or any Bank with respect to any of the Collateral, the Auburn Collateral or the Burlen Collateral which is deposited in the United States mail, certified or registered, postage prepaid and duly addressed to the applicable Loan Party, at the address specified herein, in the Auburn Security Agreement, or the Burlen Security Agreement as is applicable, at least ten (10) Business days prior to a sale, lease, disposition or other intended action with respect to any of the Collateral, the Auburn Collateral or the Burlen Collateral shall constitute fair and reasonable notice of any such action. The commencement of any legal or equitable action or the rendering of any judgment or decree for any deficiency shall not affect the Agent or any Bank's security interest in the Collateral, the Auburn Collateral or the Burlen Collateral until the Obligations are fully and finally paid. The Borrower agrees that neither the Agent nor any Bank has any obligation to preserve any rights to the Collateral, the Auburn Collateral or the Burlen Collateral against any Person. The Agent and each Bank is hereby granted a license or other right to use, without charge and until the Obligations are fully and finally paid, the Borrower's, Auburn's and Burlen's labels, patents, copyrights, rights of use of any name, trade secrets, trade names, trademarks, service marks, advertising matter, or any property of a similar nature in completing

the production and advertising for sale of any Collateral, the Auburn Collateral or the Burlen Collateral.

10.4.2 Proceeds of Disposition. The net proceeds realized by Agent upon any such sale or disposition, after deducting therefrom the expenses related thereto such as for the retaking, holding, preparing for sale and selling any of the Collateral, the Auburn Collateral or the Burlen Collateral and all reasonable attorneys' fees incurred by the Agent in connection therewith, shall be applied as provided herein toward satisfaction of the Obligations based upon each Bank's Pro Rata Share. The Agent shall account to the Borrower for any surplus realized upon, and the Borrower shall remain liable to the Agent and the Banks for any deficiency remaining after such sale or other disposition.

**Section 10.5 Marshalling; Payments Set Aside.** The Agent shall be under no obligation to make any demand upon or pursue or exhaust any rights or remedies against the Borrower or others with respect to payment of the Obligations, or to pursue or exhaust any rights or remedies with respect to any of the Collateral, the Auburn Collateral or the Burlen Collateral or any other security for the Obligations, or to marshal any assets in favor of the Borrower, Auburn, Burlen, or any other Person against or in payment of any or all of the Obligations.

**Section 10.6 Set-Off.** Upon the occurrence and during the continuation of an Event of Default, each Loan Party irrevocably authorizes the Agent and each Bank and any of their Affiliates at any time and from time to time, to the fullest extent permitted by law, to set-off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by such party to or for the credit or the account of the Borrower against any and all of the Obligations of the Borrower now or hereafter existing under this Agreement or any other Loan Documents, irrespective of whether or not such party shall have made any demand under this Agreement or any other Loan Document and although such Obligations may be unmatured. The Agent and each Bank and any applicable Affiliate shall notify the Borrower and each other after any such set-off and application is made by it or its Affiliate, provided that the failure to give such notice shall not affect the validity of such set-off and application. The rights of the Agent, the Banks and their Affiliates under this Section 10.6 are in addition to other rights and remedies (including, without limitation, other rights of set-off) which they may have hereunder or otherwise. Any set-off by the Agent or any Bank shall be for the benefit and credit of the Banks according to their respective Pro Rata Shares, and Agent and each Bank shall promptly remit such amount, if any, so set-off in excess of its Pro Rata Share to the other Banks as shall be necessary to pay each its full Pro Rata Share thereof.

**Section 10.7 Notification of Accounts.** The Borrower irrevocably authorizes the Agent upon the occurrence and continuation of an Event of Default to instruct all of the Account Debtors to make payments on the Accounts directly to the Agent. In such event, the Agent may charge the collection costs and expenses to any account maintained by the Borrower at any Bank.

**Section 10.8 Settlement of Accounts.** The Agent, without notice to or the consent of the Borrower, upon the occurrence and during the continuation of an Event of Default (1) may sue upon or otherwise collect, extend the time of payment of, or compromise or settle for cash, credit or otherwise upon any terms, any of the Accounts or any securities, instruments or

insurance applicable thereto and/or release the obligor thereon; (2) is authorized and empowered to accept the return of the goods represented by any of the Accounts; and (3) shall have the right to receive, endorse, assign and/or deliver in its name or the name of the Borrower any and all checks, drafts and other instruments for the payment of money relating to the Accounts, and the Borrower hereby waives notice of presentment, protest and non-payment of any instrument so endorsed.

**Section 10.9 Collateral Custodian.** Upon the occurrence and during the continuation of an Event of Default, the Agent may at any time and from time to time employ and maintain on the premises of any or all of the Loan Parties, a custodian selected by the Agent who shall have full authority to do all acts necessary to protect the Banks' interests and to report to the Agent thereon. The Borrower hereby agrees to cooperate with any such custodian and to do, or cause Auburn and/or Burlen to do, whatever the Agent may reasonably request to preserve the Collateral and/or the Auburn Collateral and/or the Burlen Collateral. All reasonable costs and expenses incurred by the Agent by reason of the employment of the custodian shall be charged to the Borrower's accounts, and added to the Obligations.

**Section 10.10 Waiver of Demand.** The Borrower hereby waives demand, presentment, protest and notice of nonpayment. The Borrower also waives the benefit of all laws pertaining to or otherwise concerning any valuation, appraisal and exemption of their property.

**Section 10.11 Reinstatement** If claim is ever made upon the Agent or any of the Banks for repayment, return, restoration or other recovery of any amount or amounts received by any of them in payment or on account of any of the liabilities of the Borrower to the Agent or any of the Banks repays all or part of said amount: (i) because such payment or application of proceeds is or may be avoided, invalidated, declared a fraudulent conveyance, impermissible setoff or a diversion of trust funds; or (ii) for any other reason, including, without limitation, by reason of (a) any judgment, decree or order of any court or administrative body having jurisdiction over the Agent and Banks or any of their property, or (b) any settlement or compromise of any such claim effected by the Agent or the Banks with any such claimant (including the Borrower or any other Loan Party), then and in such event each Loan Party agrees that any such judgment, decree, order, settlement or compromise shall be binding upon it, notwithstanding the cancellation of any of the Notes or other instrument evidencing any liability of it, and it shall be and remain liable to the Agent and Banks for the amount so repaid or recovered to the same extent as if such amount had never originally been received by the Agent or the Banks, as is applicable. The Borrower hereby indemnifies and shall reimburse and hold the Agent and Banks harmless for the amount so repaid and for all other claims, actions, suits, proceedings, liabilities, losses, costs and expenses of every kind (including, without limitation, the disbursements, expenses and fees of the Agent and Banks' attorneys) that may be imposed upon, incurred by or asserted against any of them in connection with defending any such claim for repayment and collecting such amount from the Borrower. The provisions of this paragraph shall survive the termination of this Agreement, and any satisfaction and discharge of the Borrower by virtue of any payment or court order or any state or federal law.

**Section 10.12 Waiver of Notice.** UPON THE OCCURRENCE OF AND DURING THE CONTINUATION OF AN EVENT OF A DEFAULT, THE BORROWER (PURSUANT

TO AUTHORITY GRANTED BY ITS BOARD OF DIRECTORS) HEREBY WAIVES ALL RIGHTS TO NOTICE AND HEARING OF ANY KIND PRIOR TO THE EXERCISE BY THE AGENT OR ANY BANK OF ITS RIGHTS TO REPOSSESS THE COLLATERAL WITHOUT JUDICIAL PROCESS OR TO APPLY, ATTACH OR LEVY UPON THE COLLATERAL WITHOUT PRIOR NOTICE OR HEARING.

**Section 10.13 Cross-Collateralization.** The security interests, liens and other rights and interests in and relative to any of the property of the Borrower, Auburn or Burlen now or hereafter granted to the Agent or any Bank by or in any instrument or agreement, including but not limited to this Agreement and the other Loan Documents, shall serve as security for any and all Obligations of the Borrower to the Agent and each of the Banks, and, the Agent and each Bank may resort to any security held by it in such order and manner as it may elect.

**Section 10.14 Auburn and Burlen Authorization.** Each of Auburn and Burlen, by its execution of this Agreement authorizes and consents to the Agent's and each Bank's exercise all of their rights and remedies set forth in this Agreement with respect to the Auburn Collateral or the Burlen Collateral.

## **ARTICLE 11**

### **THE AGENT**

**Section 11.1 Appointment of Agent.** Each Bank hereby designates BLUSA as Agent to act as herein specified. Each Bank hereby irrevocably authorizes, and each holder of any Note or participation in any Letter of Credit or Acceptance, by the acceptance of a Note or participation in a Letter of Credit, shall be deemed irrevocably to authorize the Agent to take such action on its behalf under the provisions of this Agreement, the Notes and other Loan Documents and any other instruments and agreements referred to herein and to exercise such powers and to perform such duties hereunder and thereunder as are specifically delegated to or required of the Agent by the terms hereof and thereof and such other powers as are reasonably incidental thereto. The Agent shall hold all collateral and all payments of principal, interest, fees, charges and expenses received pursuant to this Agreement or any other Loan Document for the ratable benefit of the Banks based upon their Pro Rata Shares (except to the extent any of such amounts are for the account of the Agent or the Issuer). The Agent may perform any of its duties hereunder by or through its agents or employees. The provisions of this Article 11 are solely for the benefit of the Agent and the Banks, and neither the Borrower nor any Guarantor shall have any rights as a third party beneficiary of any of the provisions hereof. Neither the Agent nor any of its directors, officers, employees or agents shall be liable as such for any action taken or omitted to be taken by it or them hereunder or under any of the other Loan Documents or in connection herewith or therewith at the request or with the approval of the Required Lenders (or, if otherwise specifically required hereunder or thereunder, the consent of all of the Banks). In performing its functions and duties under this Agreement, the Agent shall act solely as agent of the Banks and does not assume and shall not be deemed to have assumed any obligation toward or relationship of agency or trust with or for the Borrower or any Guarantor.

**Section 11.2 Nature of Duties of Agent.** The Agent shall have no duties or responsibilities except those expressly set forth in this Agreement. Neither the Agent nor any of its officers, directors, employees or agents shall be liable for any action taken or omitted by it as such hereunder or in connection herewith, unless caused by its or their gross negligence or willful misconduct. The Agent shall exercise the same standard of care in performing its duties and discharging its responsibilities as Agent for the Banks as it exercises when acting solely for its own account as a lender. The duties of the Agent shall be mechanical and administrative in nature; the Agent shall not have by reason of this Agreement a fiduciary relationship in respect of any Bank; and nothing in this Agreement, expressed or implied, is intended to or shall be so construed as to impose upon the Agent any obligations in respect of this Agreement except as expressly set forth herein. The Agent, by fax, shall send each Bank (i) a copy of each request for an Advance within one (1) day after the Agent's receipt of the request, and (ii) within one (1) day after the receipt of its request, notice of each request for a Letter of Credit and Acceptances. The Agent is hereby expressly authorized on behalf of the Banks, without hereby limiting any implied authority, (a) to receive on behalf of each of the Banks any payment of principal of or interest on the Loans, any amounts due in respect of Letters of Credit and Acceptance, fees and all other amounts accrued hereunder paid to the Agent, and to distribute to each Bank its Pro Rata Share of all payments so received (except as otherwise provided in Section 2.7.3, or elsewhere herein to the extent any of such amounts are for the account of the Agent or the Issuer), (b) to distribute to each Bank copies of all notices, agreements and other material as provided for in this Agreement and the other Loan Documents as received by the Agent (but without obligating the Agent to do so except as expressly set forth herein) and (c) to take all actions with respect to this Agreement and the other Loan Documents as are specifically delegated to the Agent. The Banks hereby acknowledge that the Agent shall be under no duty to take any discretionary action permitted to be taken by the Agent pursuant to the provisions of this Agreement or any of the other Loan Documents unless it shall be requested in writing to do so by the Required Lenders, or all of the Banks.

**Section 11.3 Lack of Reliance on Agent.** Independently and without reliance upon the Agent, each Bank, to the extent it deems appropriate, has made and shall continue to make (a) its own independent investigation of the financial or other condition and affairs of the Borrower in connection with the taking or not taking of any action in connection herewith and (b) its own appraisal of the creditworthiness of the Borrower, and, except as expressly provided in this Agreement, the Agent shall have no duty or responsibility, either initially or on a continuing basis, to provide any Bank with any credit or other information with respect thereto, whether coming into its possession before the making of any Advance, issuing any Letters of Credit, or creating an Acceptance or at any time or times thereafter. The Agent shall not be responsible to any Bank for any recitals, statements, information, representations or warranties herein or in any document, certificate or other writing delivered in connection herewith or for the execution, effectiveness, genuineness, validity, enforceability, collectibility, priority or sufficiency of this Agreement or any of the other Loan Documents or the financial or other condition of the Borrower or any Guarantor. The Agent shall not be required to make any inquiry concerning either the performance or observance of any of the terms, provisions or conditions of this Agreement or any other Loan Document, or the financial condition of the Borrower or any Guarantor, or the existence or possible existence of any Default or Event of Default, unless specifically requested to do so in writing by a Bank.

**Section 11.4 Instructions to Agent.**

11.4.1 Required Consents. Whenever the Agent, before taking any action, is required to obtain the consent of the Banks or the Required Lenders it shall give each Bank notice thereof, including the action to be taken. Each Bank within eight (8) Business Days from the giving of such notice shall give the Agent notice as to whether or not it consents to the taking of such action. If a Bank shall not timely respond to the Agent, it shall be deemed not to have given its consent.

11.4.2 Right to Request Instructions from the Banks. The Agent also shall have the right to request instructions from each Bank. If the Agent shall request instructions from any Bank with respect to any act or action (including the failure to act) in connection with this Agreement, the Agent shall be entitled to refrain from such act or taking such action unless and until the Agent shall have received instructions from such Bank and the Agent shall not incur liability to any Person by reason of so refraining. Without limiting the foregoing, no Bank shall have any right of action whatsoever against the Agent as a result of the Agent acting or refraining from acting hereunder in accordance with the instructions of such Bank.

**Section 11.5 Reliance by Agent.** The Agent shall be entitled to rely, and shall be fully protected in relying, upon any note, writing, resolution, notice, statement, certificate, telex, teletype or telecopier message, cablegram, order or other documentary, teletransmission or telephone message believed by it to be genuine and correct and to have been signed, sent or made by the proper Person. The Agent may consult with legal counsel (including counsel for the Borrower with respect to matters concerning the Borrower), independent public accountants and other experts selected by it and shall not be liable nor any action taken or omitted to be taken by it in good faith in accordance with the advice of such counsel, accountants or experts. Without limiting the generality of the foregoing, the Agent shall, in the absence of knowledge to the contrary, be entitled to accept any certificate furnished pursuant to this Agreement or any of the other Loan Document as conclusive evidence of the facts stated therein and shall be entitled to rely on any note, notice, consent, certificate, affidavit, letter, telegram, teletype message, statement, order or other document which it believes in good faith to be genuine and correct and to have been signed or sent by the proper person or persons. It is understood and agreed that the Agent may exercise its rights and powers under other agreements and instruments to which it is or may be a party, and engage in other transactions with the Borrower, as though it were not Agent of the Banks hereunder.

**Section 11.6 Indemnification of Agent.** To the extent the Agent is not reimbursed by the Borrower, each Bank agrees to reimburse and indemnify the Agent, and any of its directors, officers, employees or agents on demand in proportion to its Pro Rata Share, for and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses (including counsel fees, disbursements and compensation of agents and employees rendered on behalf of the Banks) or disbursements of any kind or nature whatsoever which may be imposed on, incurred by or asserted against the Agent in performing its duties hereunder, in any way relating to or arising out of this Agreement or any other Loan Document, provided that no Bank shall be liable for any portion of such liabilities, obligations, losses, damages, penalties,



actions, judgments, suits, costs, expenses or disbursements resulting from the Agent's gross negligence or willful misconduct. Notwithstanding anything to the contrary contained herein, no Bank shall be required to reimburse the Agent for ordinary administrative expenses incurred by Agent in connection with the Loans.

**Section 11.7 The Agent in its Individual Capacity.** With respect to its obligation to lend under this Agreement, the Loans made by it, and its participation in Letters of Credit issued and Acceptances created hereunder, the Agent shall have the same rights and powers hereunder as any other Bank, or participation interest and may exercise the same as though it was not performing the duties specified herein. The Agent and each Bank may accept deposits from, lend money to, acquire equity interests in, and generally engage in any kind of banking, trust, financial advisor or other business with the Borrower or any Guarantor or any Affiliate of the Borrower or any Guarantor as if it were not performing the duties specified herein, and may accept fees and other consideration from the Borrower or any Guarantor for services in connection with this Agreement and otherwise without having to account for the same to any Bank.

**Section 11.8 Successor Agent.**

11.8.1 The Agent may, on notice to the Banks and the Borrower, may resign at any time (effective upon the appointment of a successor Agent pursuant to the provisions of this Section 11.8.1) by giving written notice thereof to the Banks and the Borrower. Upon any such resignation, Bank Hapoalim B.M. shall have the right upon seven (7) days' notice to the Agent and each other Bank, to agree by notice to the other Banks to serve as a successor Agent. If Bank Hapoalim B.M. does not agree to serve as successor agent, the Banks within ten (10) days after the expiration of such seven (7) day period shall appoint a successor Agent. If no successor Agent shall have been so appointed, and shall have accepted such appointment, within thirty (30) days after the retiring Agent's giving of notice of resignation, then, upon five (5) days' notice and approval by the Borrower (which approval shall not be unreasonably withheld), the retiring Agent may, on behalf of Banks, appoint a successor Agent, which shall be a bank or a trust company or other financial institution which maintains an office in the United States, or a commercial bank organized under the laws of the United States of America or of any State thereof, or any Affiliate of such bank or trust company or other financial institution which is engaged in the banking business, having a combined capital and surplus of at least \$50,000,000.

11.8.2 If the Commitment of the Agent in its capacity as a Bank, at any time shall fall below the greater of (i) \$10,000,000, or (ii) fifty percent (50%) of the Commitment of the Bank with the smallest Commitment of all of the Banks, then and in such event upon notice to the Agent given by Banks holding in the aggregate at least fifty percent (50%) Pro Rata Share of the total Commitment of all of the Banks, the Agent shall be deemed to have resigned as is provided for in Section 11.8.1, and the provisions thereof with respect to the appointment of a successor Agent shall control. For the purposes of this Section 11.8.2 only, in determining a Bank's total Commitment of all of the Banks, a Bank's Commitment shall include (i) any portion thereof in which an Affiliate of such Bank holds a participation, and (ii) any Commitment acquired by an Affiliate by means of an assignment, as provided for in Section 12.14.3 of this Agreement.

11.8.3 Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the retiring Agent, and the retiring Agent shall be discharged from its duties and obligations under this Agreement from and after such date. After any retiring Agent's resignation hereunder as Agent, the provisions of this Section 11.8 shall inure to its benefit as to any actions taken or omitted to be taken by it while it was Agent under this Agreement.

11.8.4 In the event any Bank claims that Agent is in material breach of this Agreement, it shall promptly notify the Agent thereof, which notice shall set forth in detail the nature of the claimed default. In the event of such material breach by the Agent of its duties hereunder, which breach is not cured within thirty (30) days after notice from any Bank, the Agent may be removed by Banks holding more than fifty (50%) percent of the total commitment of all of the Banks (exclusive of the Commitment of the Agent in its capacity as a Bank, and without having any effect upon any Loans, or Letters of Credit, or Acceptances made by the Agent as a Bank) for cause and the provisions of this Section 11.8 shall apply to the appointment of a successor Agent. In the case of any removal of the Agent under the provisions of this Section 11.8.4 hereof, the Agent shall also no longer be required to act as an Issuer, except in so far as it is a Bank, and such obligation shall be responsibility of the successor Agent who shall have all its rights, powers, privileges and duties.

#### **Section 11.9 Collateral Matters.**

11.9.1 Each Bank authorizes and directs the Agent to enter into each of the Loan Documents for the benefit of the Banks. Each Bank hereby agrees, that, except as otherwise set forth herein, any action taken by any Bank in accordance with the provisions of this Agreement or the Loan Documents, and the exercise by any of the Banks of its rights set forth herein shall be authorized and binding upon all of the Banks, it being agreed however, that only the Agent shall have the authority to act hereunder. The Agent is hereby authorized on behalf of each of the Banks, without the necessity of any notice to or further consent from any Bank, from time to time prior to an Event of Default, to take any action with respect to any Collateral, the Auburn Collateral or the Burlen Collateral, which may be necessary to perfect and maintain perfected the security interest in and Liens upon the Collateral, the Auburn collateral, or the Burlen Collateral granted pursuant hereto or pursuant to any other Loan Document.

11.9.2 The Banks hereby authorize the Agent, at its option and in its discretion, to release any Lien granted to or held by the Agent upon any Collateral, the Auburn Collateral or the Burlen Collateral (a) upon termination of this Agreement and payment and satisfaction of all of the Obligations at any time arising under or in respect of this Agreement or the Loan Documents or the transactions contemplated hereby or thereby, or (b) if approved, authorized or ratified in writing by each Bank. Upon request by the Agent at any time, each Bank will confirm in writing the Agent's authority to release particular types or items of collateral pursuant to this Section 11.9.2.

11.9.3 Upon any sale and transfer of any Collateral, Auburn Collateral or Burlen Collateral which is expressly permitted pursuant to the terms of this Agreement, and upon at

least five (5) Business Days' prior written request by the Borrower, the Agent shall (and is hereby irrevocably authorized by the Banks to) execute such documents as may be necessary to evidence the release of the Liens granted to the Agent for the benefit of the Banks herein or pursuant hereto upon the collateral that was sold or transferred; provided that (a) the Agent shall not be required to execute any such document on terms which, in the Agent's opinion, would expose the Agent to liability or create any obligation or entail any consequence other than the release of such Liens without recourse or warranty and (b) such release shall not in any manner discharge, affect or impair the Obligations or any Liens upon (or obligations of the Borrower in respect of) all interests in any Collateral, Auburn Collateral or Burlen Collateral retained by the Borrower, Auburn or Burlen including, without limitation, the proceeds of the sale, all of which shall continue to constitute part of the Collateral, the Auburn Collateral or the Burlen Collateral. In the event of any sale or transfer of any Collateral, the Auburn Collateral or the Burlen Collateral or any foreclosure with respect to any of such collateral, the Agent shall be authorized to deduct all of the expenses reasonably incurred by the Agent from the proceeds of any such sale, transfer or foreclosure.

11.9.4 The Agent shall have no obligation whatsoever to the Banks or to any other Person to assure that the Collateral, the Auburn Collateral or the Burlen Collateral exists or is owned by the applicable Loan Party or is cared for, protected or insured or that the Liens granted to the Agent herein or pursuant hereto have been properly or sufficiently or lawfully created, perfected, protected or enforced or are entitled to any particular priority, or to exercise or to continue exercising at all or in any manner or under any duty of care, disclosure or fidelity any of the rights, authorities and powers granted or available to the Agent in this Agreement or in any other Loan Document, it being understood and agreed that in respect of such Collateral, the Auburn Collateral and the Burlen Collateral, or any act, omission or event related thereto, the Agent may act in any manner it may deem appropriate, in its sole discretion, given the Agent's own interest in such collateral as one of the Banks and that the Agent shall have no duty or liability whatsoever to the Banks, except for its gross negligence or willful misconduct.

**Section 11.10 Actions with Respect to Defaults.** In the event that the Agent receives notice of the occurrence of a Default or an Event of Default, the Agent shall promptly give notice thereof to the Banks, and shall take such action with respect to such Event of Default or other condition or event as it shall be directed to take by the Required Lenders; provided, that, until the Agent shall have received such directions, the Agent may (but shall not be obligated to) take such action or refrain from taking such action, with respect to such Default or Event of Default as it shall deem advisable and in the best interests of the Banks.

**Section 11.11 Delivery of Information.** The Agent shall not be required to deliver to any Bank originals or copies of any documents, instruments, notices, communications or other information received by the Agent from the Borrower, any Bank or any other Person under or in connection with this Agreement or any other Loan Document, except (i) if sent or received pursuant to Articles 7 and 9 of this Agreement, (ii) as specifically provided in this Agreement or any other Loan Document and (iii) as specifically requested from time to time in writing by any Bank with respect to a specific document, instrument, notice or other written communication received by and in the possession of the Agent at the time of receipt of such request and then only in accordance with such specific request.

## ARTICLE 12

### MISCELLANEOUS

**Section 12.1 Expenses.** The Borrower agrees upon demand to pay, or reimburse the Agent and each Bank for all reasonable costs, fees, expenses and liabilities incurred by the Agent and each Bank or for which any of them becomes obligated in connection with or arising out of (i) the negotiation, preparation, closing and enforcement of this Agreement, any amendment hereof, any agreements, documents and instruments in any way relating hereto and any of their rights hereunder, (ii) the exercise by the Agent or any Bank of any of their rights without respect to the Collateral, the Auburn Collateral, or the Burlen Collateral and the Obligations, including, without limitation, protecting its interests in any bankruptcy proceeding involving the Borrower, (iii) any Advance, Letter of Credit or Acceptance requested pursuant to this Agreement (iv) any inspection or verification of the Collateral, the Auburn Collateral, or the Burlen Collateral or the financial condition of any Loan Party (which may include the internal charges of the Agent or any Bank or any of the Affiliates), and (v) any actual or potential liability of the Borrower, any Loan Party, their Affiliates, or the Agent or any Bank by reason of any Environmental Complaint, Release, threatened Release or any other environmental, health or safety matter concerning the Borrower, its Affiliates, the Collateral, the Auburn Collateral or the Burlen Collateral or the Premises without regard to whether the Borrower is complying with Section 7.14 of this Agreement, all of the foregoing to include, without limitation, all reasonable fees for the employment of professionals including but not limited to, legal fees and disbursements, accountants, asset based lender review auditors as provided herein, appraisers of real estate and environmental engineers and consultants, all lien search and title fees, and all title insurance premiums, all filing and recording fees, and all travel expenses. All of the foregoing shall be part of the Obligations, payable on demand, together with interest thereon at the Prime Rate.

**Section 12.2 Indemnity.** The Borrower further agrees to defend, protect, indemnify and hold harmless the Agent, each Bank and their respective officers, directors, employees, attorneys and agents from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, claims, costs, expenses and disbursements of any kind or nature whatsoever (including, without limitation, the reasonable fees and disbursements of counsel which may be imposed on, incurred by, or asserted against such Persons, whether direct or indirect or consequential) relating to or arising out of the Loan Documents, the Collateral, the Auburn Collateral or the Burlen Collateral, or any Loan Party's assets or any act, event or transaction related or attendant hereto or thereto, the making of an Advance or the use of the proceeds of the Loans, Letters of Credit or Acceptances any amount required to be expended in connection therewith, together with interest thereon at the Prime Rate, being part of the Obligations, payable on demand; provided that the Borrower shall have no obligation with respect to any matter which is determined, by final order of a court of competent jurisdiction, to have been caused by or to have resulted from the gross negligence or willful misconduct of that Person.

**Section 12.3 No Agency.** Nothing herein contained shall be construed to constitute the Borrower as agent of the Agent or any Bank for any purpose whatsoever, and neither the Agent

nor any Bank shall be responsible or liable for any shortage, discrepancy, damage, loss or destruction of any part of the Collateral, the Auburn Collateral or the Burlen Collateral wherever the same may be located and regardless of the cause thereof, unless arising from the Agent or such Bank's gross negligence or willful act. Neither the Agent nor any Bank shall, under any circumstances or in any event whatsoever, have any liability for any error or omission or delay of any kind occurring in the settlement, collection or payment of any of the Accounts or any instrument received in payment thereof or for any damage resulting therefrom unless arising from the Agent or such Bank's gross negligence or willful act. Neither the Agent nor any Bank, by anything herein or in any assignment or otherwise, assumes any of the Borrower's obligations under any contract or agreement assigned to it, and none of them shall be responsible in any way for the performance by the Borrower of any of the terms and conditions thereof.

**Section 12.4 Expenditures.** In the event any Loan Party shall fail to pay taxes, insurance premiums, assessments, costs or expenses which such Loan Party is required to pay under terms hereof, or fails to keep the Collateral, the Auburn Collateral, or the Burlen Collateral provided by it to secure the Obligations free from security interests, liens or encumbrances, except as permitted herein, the Agent or any Bank may, in its sole and absolute discretion, make expenditure for any or all of the above and any amount so expended, together with interest thereon at the Prime Rate of Bank Leumi USA, shall be part of the Obligations, payable on demand.

**Section 12.5 Limitation of Liability.** Neither the Agent nor any Bank nor any of their Affiliates, directors officers, agents, attorneys or employees shall be liable to the Borrower for any action taken or omitted to be taken, by it or them or any of them under the Loan Documents or in connection therewith or with the Collateral, Auburn Collateral or Burlen Collateral except that no such Person shall be relieved of any liability for its own or any other such Person's gross negligence or willful misconduct as determined by final order of a court of competent jurisdiction.

**Section 12.6 Reliance by Banks.** All covenants, agreements, representations and warranties made herein by the Borrower shall, notwithstanding any investigation made by or submitted to the Agent or any Bank, be deemed to have been relied upon by the Agent and each Bank. The Agent and each Bank shall be entitled to rely upon any notice, consent, certificate, affidavit, statement, paper, document, writing or other communication reasonably believed by it to be genuine and to have been signed, sent or made by the proper Person or Persons, and upon opinions and advice of legal counsel, independent public accountants and other experts selected by it. The Agent and each Bank shall be entitled to rely, and in entering into this Agreement and the other Loan Documents in fact has relied, upon the representations, warranties and other information respecting the Borrower or Guarantor contained in this Agreement and the other Loan Documents notwithstanding any investigation, analysis or evaluation that may be made by analysis or evaluation or that may have been made or from time to time may be made by the Agent or any Bank or its designees of all or any part of the assets, business, operations, properties, condition (financial or otherwise) of the Borrower or any other Person.

**Section 12.7 Applicable Law.** This Agreement, and the other Loan Documents shall be governed by, and construed in accordance with, the laws of the State of New York, without

reference to the principles of conflicts of laws.

**Section 12.8 Submission to Jurisdiction; Waiver of Bond.** THE BORROWER AND THE BANKS HEREBY MUTUALLY CONSENT TO THE JURISDICTION OF ANY LOCAL, STATE OR FEDERAL COURT SITUATED IN THE STATE AND COUNTY OF NEW YORK AND WAIVE ANY OBJECTION WHICH THEY MAY HAVE PERTAINING TO IMPROPER VENUE OR FORUM NON CONVENIENS TO THE CONDUCT OF ANY PROCEEDING IN ANY SUCH COURT. THE BORROWER WAIVES PERSONAL SERVICE OF ANY AND ALL PROCESS UPON IT AND CONSENTS THAT ALL SUCH SERVICE OF PROCESS BE MADE BY CERTIFIED MAIL - RETURN RECEIPT REQUESTED DIRECTED TO IT AT THE ADDRESS SPECIFIED HEREIN AND SERVICE SO MADE SHALL BE DEEMED TO BE COMPLETED THREE (3) BUSINESS DAYS AFTER SUCH PROCESS SHALL HAVE BEEN DEPOSITED IN THE U.S. MAIL, POSTAGE PREPAID. THE BORROWER WAIVES, TO THE EXTENT PERMITTED BY LAW, ANY BOND OR SURETY OR SECURITY UPON SUCH BOND WHICH MIGHT, BUT FOR THIS WAIVER, BE REQUIRED OF ANY BANK OR THE AGENT. NOTHING CONTAINED HEREIN SHALL AFFECT THE RIGHT OF A BANK OR THE AGENT TO SERVE LEGAL PROCESS IN ANY OTHER MANNER PERMITTED BY LAW OR AFFECT THE RIGHT OF A BANK OR AGENT TO BRING ANY ACTION OR PROCEEDING AGAINST THE BORROWER OR ITS PROPERTY IN THE COURTS OF ANY OTHER JURISDICTION.

**Section 12.9 Titles.** The article, section and subsection titles contained in this Agreement shall be without substantive meaning or content of any kind whatsoever and are not part of the agreement between the parties.

**Section 12.10 Binding Effect.** This Agreement shall be binding upon and inure to the benefit of the Borrower and the Agent and each Bank, and their respective successors and assigns, except that the Borrower shall not have the right to assign its rights hereunder or any interest herein without the prior written consent of each Bank.

**Section 12.11 Notices.** Except as otherwise expressly provided for herein and except as to any service of legal process, any notice or other communication required or desired to be given hereunder shall be in writing and shall be deemed to have been validly given upon the earlier of actual receipt by manual delivery or teletransmission one (1) day after depositing with a reputable overnight courier service or three (3) days after being mailed by registered or certified mail, postage prepaid, to the party entitled to such notice or other communication at the address of such party as set forth herein. Counsel for a party can give any notices on behalf of its client.

Notices to the Agent shall be sent to:

Bank Leumi USA  
564 Fifth Avenue  
New York, New York 10036  
Attn: Michaela Klein, Senior Vice President

Telephone: 212-626-1058  
Telecopier: 212-626-1072

with copies to each Bank (which copies shall not constitute notice) at its address set forth on Schedule 1.1 annexed hereto.

Notices to the Borrower shall be sent to:

Delta Galil USA Inc.  
150 Meadowlands Parkway  
Secaucus, New Jersey 07094  
Attn: Chief Financial Officer  
Telephone: 570-326-2451  
Telecopier: 570-325-9332

with a copy to:

Pryor Cashman Sherman & Flynn LLP  
410 Park Avenue  
New York, New York 10022  
Attn: Lawrence Rimmel, Esq.  
Telephone: 212-421-4100  
Telecopier: 212-326-0806

**Section 12.12 Severability.** In case any one or more of the provisions contained in this Agreement or any other Loan Document should be invalid, illegal, or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein and therein shall not in any way be affected or impaired thereby so long as it does not impair on the ability of the Agent or any Bank to recover the moneys lent and applicable interest thereon and expenses as provided herein.

**Section 12.13 Successors and Assigns; Participations.**

12.13.1 Whenever in this Agreement any of the parties hereto is referred to, such reference shall be deemed to include the successors and permitted assigns of such party; and all covenants, promises and agreements by or on behalf of the Borrower and each Guarantor, any Affiliate, the Agent or the Banks, that are contained in this Agreement shall bind and inure to the benefit of their respective successors and permitted assigns. Without limiting the generality of the foregoing, the Borrower specifically confirms that any Bank may at any time and from time to time pledge or otherwise grant a security interest in any Revolving Loan, the Term Loan, the Revolving Note or Term Note (or any part thereof) to any Federal Reserve Bank. The Borrower may not assign or transfer any of its rights or obligations hereunder without the prior written consent of all the Banks.

12.13.2 Each Bank, without the consent of the Borrower and at no expense to the Borrower, may sell participations to one or more banks or other entities in all or a portion of its

rights and obligations under this Agreement (including, without limitation, all or a portion of the Loans owing to it); provided, however, that (i) such Bank's obligations under this Agreement (including, without limitation, its Commitment) shall remain unchanged, (ii) such Bank shall remain solely responsible to the other parties hereto for the performance of such obligations, (iii) the banks or other entities buying participations shall be entitled to benefits of Article II hereof, but only to the extent any of the Sections in such Article would be available to the Bank which sold such participation, and (iv) the Borrower, the Agent and the other Banks shall continue to deal solely and directly with the Bank in connection with such Bank's rights and obligations under this Agreement; provided, further, however, that each Bank shall retain the sole right and responsibility to enforce the obligations of the Borrower and the Guarantors, including, without limitation, the right to approve any amendment, modification or waiver of any provision of this Agreement, other than amendments, modifications or waivers with respect to any fees payable hereunder or the amount of principal or the rate of interest payable on, or the dates fixed for any payment of principal or interest on the Loans or any reimbursement agreement with respect to any Letter of Credit or the release of any Collateral, Auburn Collateral or Burlen Collateral.

12.13.3 Each Bank (an "Assigning Bank") on notice to the Agent and the other Bank, and subject to its rights as herein provided, may assign by novation, to an Affiliate of such Assigning Bank, to any other Bank or to any one or more commercial banks having capital and surplus in excess of \$1,000,000,000, all or a portion of its interests, rights and obligations under this Agreement and the other Loan Documents (including, without limitation, all or a portion of its Bank Commitment) provided, however, that (i) prior to or concurrently with such assignment, the Assigning Bank shall obtain the prior written consent (which shall not be unreasonably withheld) of each other Bank; except that the consent of each other Bank shall not be required for an assignment to an Affiliate of the Assigning Bank or to another Bank, (ii) each such assignment shall be of a constant, and not a varying, percentage of all of the Assigning Bank's rights and obligations under this Agreement, which shall include the same percentage interest in each of the Loans made by the Assigning Bank and its participation obligation with respect to Letters of Credit and Acceptances, (iii) except in the case of an assignment to another Bank or to an Affiliate of the Assigning Bank, the amount of the portion of the Bank Commitment of the assigning Bank being assigned pursuant to each such assignment (determined as of the date the notice of with respect to such assignment is delivered to the Agent) shall not be less than \$10,000,000, unless the Agent and the other Banks otherwise consent, and (iv) the parties to each such assignment shall execute and deliver to the Agent, with the consent of the Agent attached (if and to the extent required under the provisions of this Section 12.13.3) for recording in the Register (as defined below), an assignment and consent in such form as the Agent reasonably shall require (an "Assignment"), together with a processing and recordation fee of \$10,000. A Bank in receipt of a notice from an Assigning Bank of its intention to assign a portion of its Bank Commitment to a bank which is neither an Affiliate of the Assigning Bank nor a Bank shall have the right to either (i) acquire by assignment the portion of the Bank Commitment to be assigned by the Assigning Bank or (ii) to join with the Assigning Bank and, on the same terms and conditions, assign to such unaffiliated third party bank an amount equal to its Pro Rata Share of the total amount of the Bank Commitment to be assigned as herein provided. The recipient Bank shall give the Assigning Bank notice of its intention to exercise its right to acquire the part of the Assigning Banks' Bank Commitment to be assigned, or to participate in such assignment within three (3) Business Days of its receipt of the notice of the intention to assign. Upon such



execution, delivery, and recording and after receipt of the written consent of the other Bank (if and to the extent required hereunder), from and after the effective date specified in each Assignment, which effective date shall be at least five (5) Business Days after the execution thereof, (x) the assignee thereunder shall be a party hereto and, to the extent provided in such Assignment, have the rights and obligations of a Bank hereunder and under the other Loan Documents and (y) the Bank which is the assignor thereunder shall, to the extent provided in such Assignment, be released from its obligations under this Agreement (and, in the case of an Assignment covering all or the remaining portion of an assigning Bank's rights and obligations under this Agreement, such Bank shall cease to be a party hereto).

12.13.4 By executing and delivering an Assignment, the Bank which is the assignor thereunder and the assignee thereunder confirm to, and agree with, each other and the other parties hereto as follows: (i) other than the representation and warranty that it is the legal and beneficial owner of the interest being assigned thereunder free any adverse claim, such Bank makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with this Agreement or the execution, legality, validity, enforceability, perfection, genuineness, sufficiency or value of this Agreement, the other Loan Documents, any Collateral, any Auburn Collateral, or any Burlen Collateral with respect thereto or any other instrument or document furnished pursuant hereto or thereto; (ii) such Bank makes no representation or warranty and assumes no responsibility with respect to the financial condition of any Borrower or any Guarantor or the performance or observance by any Borrower or any Guarantor of any of their respective obligations under this Agreement, or any of the other Loan Documents or any other instrument or document furnished pursuant hereto or thereto; (iii) such assignee confirms that it has received a copy of this Agreement, and of the other Loan Documents, together with copies of financial statements and such other documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into such Assignment; (iv) such assignee shall, independently and without reliance upon the Agent, such Bank or any other Bank and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement; (v) such assignee appoints and authorizes the Agent to take such action as the Agent on its behalf and to exercise such powers under this Agreement as are delegated to the Agent by the terms hereof, together with such powers as are reasonably incidental thereto; and (vi) such assignee agrees that it shall perform in accordance with their terms all of the obligations which by the terms of this Agreement are required to be performed by it as a Bank.

12.13.5 The Agent shall maintain at its address referred to in Section 12.11 hereof a copy of each Assignment delivered to it and a register for the recordation of the names and addresses of the Banks and the Bank Commitment of each Bank from time to time, and each Bank's Pro Rata Share of the Commitment of all of the Banks and the Term Loan then outstanding (the "Register"). The entries in the Register shall be conclusive, in the absence of manifest error, and the Borrower, the Agent and the Banks may treat each person whose name is recorded in the Register as a Bank hereunder for all purposes of this Agreement. The Register shall be available for inspection by the Borrower or any Bank at any reasonable time and from time to time upon reasonable prior notice.

12.13.6 Upon its receipt of an Assignment executed by an Assigning Bank and the assignee and the written consent to such assignment from the other Bank (if and to the extent required under Section 12.13.3 hereof), the Agent shall, if such Assignment has been completed to its reasonable satisfaction, (i) accept such Assignment, (ii) record the information contained therein in the Register and (iii) give prompt notice thereof to the Banks and the Borrower.

12.13.7 Notwithstanding any other provision herein, any Bank may, in connection with any assignment or participation or proposed assignment or participation pursuant to this Section 12.14, disclose to the assignee or participant or proposed assignee or participant, any information, including, without limitation, any information relating to the Borrower or Guarantor furnished to such Bank by or on behalf of the Borrower or Guarantor in connection with this Agreement; provided, however, that prior to any such disclosure, each such assignee or participant or proposed assignee or participant shall agree to preserve the confidentiality of any confidential information relating to the Borrower or any Guarantor received from such Bank.

**Section 12.14 Waivers and Amendments.** (a) No failure or delay of the Agent or any Bank in exercising any power or right hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power, or any abandonment or discontinuance of steps to enforce such right or power, preclude any other or further exercise thereof or the exercise of any other right or power. The rights and remedies of the Agent and the Banks hereunder are cumulative and not exclusive of any rights or remedies which they may otherwise have. No waiver of any provision of this Agreement or any other Loan Document nor consent to any departure by the Borrower therefrom shall in any event be effective unless the same shall be authorized as provided in paragraph (b) below, and then such waiver or consent shall be effective only in the specific instance and for the purpose for which given. No notice to or demand on the Borrower in any case shall entitle it to any other or further notice or demand in similar or other circumstances.

(b) Neither this Agreement or any other Loan Document, nor any provision hereof or thereof may be waived, amended or modified except pursuant to an agreement or agreements in writing entered into by the Borrower and the Required Lenders; provided, however, that no such agreement shall (i) change the principal amount of, or extend or advance the maturity of or the dates for the payment of principal of or interest on any of the Loans or reduce the rate of interest on any of the Loans, (ii) change the Pro Rata Share of any Bank or amend or modify or waive the provisions of this Section 12.4, Section 2.7, Section 2.11.4, Section 2.12, Section 7.12, Section 8.1 through Section 8.20 and Articles 9 and 11 hereof or the definition of "Maturity Date", "Required Lenders" or "Borrowing Base", (iii) release any material portion of the Collateral, the Auburn Collateral or the Burlen Collateral (iv) release the Borrower or any Guarantor from such Person's obligations under this Agreement or any other Loan Document; (v) extend any cure period in which to cure a monetary default or the forbearance of any right or remedy able to be exercised pursuant to the terms of the Loan Documents in connection with a monetary default; and (vi) consent to an assignment by the Borrower of any of the Borrower's rights or obligations under this Agreement or the other Loan Documents; in each case without the prior written consent of all of the Banks; and provided, further, however, that no such agreement shall amend, modify or otherwise affect the rights or duties of the Agent under this Agreement or the other Loan Documents without the written

consent of the Agent.

**Section 12.15 Survival of Representations and Warranties.** All representations and warranties contained in this Agreement or any other Loan Documents shall survive the execution and delivery of this Agreement and shall continue in full force and effect as long as any Obligation is outstanding.

**Section 12.16 Complete Agreement.** This Agreement and the other Loan Documents set forth exhaustively the complete undertaking and agreement of the Agent, each Bank and the Borrower as to the subject matter hereof, and there are no other agreements or understandings binding upon them. Without limiting the foregoing, the Borrower expressly acknowledges and agrees that neither the Agent nor any Bank has made any commitments and assumed no obligations whatsoever with respect to any consent or waiver which may have been or may at any time be requested by the Borrower as to the restrictions set forth in any provision of this Agreement.

**Section 12.17 Counterparts; Facsimile Signatures.** This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same Agreement. Delivery of a facsimile copy of an executed counterpart of a signature page shall be effective as a manually executed signature page to this Agreement.

**Section 12.18 No Presumption.** The parties acknowledge and agree that: each party and its counsel have reviewed and have had an opportunity to negotiate the terms and provisions of the Agreement and the other Loan Documents and have contributed or have been offered the opportunity to contribute to their revision; the normal rule of construction, to the effect that any ambiguities are resolved against the drafting party, shall not be employed in the interpretation of them; and their terms and provisions shall be construed fairly as to all parties hereto and not in favor of or against any party, regardless of which party was generally responsible for the preparation of this Agreement and the other Loan Documents.

**Section 12.19 No Third Party Beneficiaries.** The terms and provisions of this Agreement are for the exclusive benefit of the parties hereto, and no other person, including creditors of any party hereto, shall have any right or claim against any party by reason of those provisions or be entitled to enforce any of those terms and provisions against any party.

**Section 12.20 Waiver of Jury Trial.** THE BORROWER, THE AGENT AND EACH BANK ACKNOWLEDGES THAT THE PROMPT RESOLUTION OF DISPUTES IS IN THE INTERESTS OF ALL PARTIES AND THAT A TRIAL WITH A JUDGE AS THE SOLE FINDER OF FACT WOULD BE THE MOST EXPEDITIOUS MANNER TO RESOLVE SUCH DISPUTES. THE BORROWER, THE AGENT AND THE BANKS HEREBY WAIVE, TO THE FULLEST EXTENT PERMITTED BY LAW, TRIAL BY JURY IN ANY SUIT, ACTION OR PROCEEDING ON ANY MATTER ARISING IN CONNECTION WITH OR IN ANY WAY RELATED TO THIS AGREEMENT AND/OR THE LOAN DOCUMENTS. THE PARTIES ACKNOWLEDGE THAT THEY MAKE THIS WAIVER KNOWINGLY AND VOLUNTARILY, AFTER EXTENSIVE CONSIDERATION WITH THEIR RESPECTIVE

ATTORNEYS OF THE RAMIFICATIONS OF THIS WAIVER.

**[BALANCE OF PAGE INTENTIONALLY LEFT BLANK]**

**IN WITNESS WHEREOF**, this Agreement has been duly executed on December 9, 2004, and is effective as of the day and year first above written.

**DELTA GALIL USA INC.**

By: \_\_\_\_\_  
Steven Lockcuff  
Vice President for Finance and Secretary

**BANK LEUMI USA**

By: \_\_\_\_\_  
Michaela Klein  
Senior Vice President

By: \_\_\_\_\_  
Yuval Talmy  
Vice President

**BANK HAPOALIM, B.M.**

By: \_\_\_\_\_  
Maxine Levy  
Vice President

By: \_\_\_\_\_

The undersigned agrees to observe and perform, and to be bound by, all of the provisions of this Second Amended and Restated Credit and Security Agreement relating to it, including, with limitation, the provisions of Article 10.

AUBURN HOSIERY MILLS, INC.

BURLEN CORP.

By: \_\_\_\_\_  
Steven Lockcuff, Treasurer and Secretary

By: \_\_\_\_\_  
Steven Lockcuff, Treasurer and Assistant Secretary

The Terms and conditions of this Agreement are approved.

DELTA GALIL INDUSTRIES LTD.

By: \_\_\_\_\_

## Schedule 1.1

### PRO RATA SHARE

Bank Leumi USA  
564 Fifth Avenue  
New York, New York 10036  
Attn: Mr. Yuval Talmy, Vice President  
Telephone: 212-626-1061  
Telecopier: 212-626-1072 50%

Bank Hapoalim B.M.\*  
1177 Avenue of the Americas  
New York, New York 10036  
Attn: Ms. Maxine Levy, Vice President  
Telephone: 212-782-2166  
Telecopier: 212-782-2171 50%

\*Copies of notices shall also go to:

Bank Hapoalim B.M.  
1177 Avenue of the Americas  
New York, NY 10036  
Attn: Renee Rivkis, Esq.  
Telephone: 212-782-2166  
Telecopier: 212-782-2141

### **Schedule 3.3.1: Real Estate Collateralization Documents**

#### **A. Real Estate Collateralization Documents**

1. Amended and Restated Open-End Mortgage and Security Agreement and Assignment of Leases and Rents by the Borrower to the Agent, as agent for the Banks, to be recorded in the Recorder's Office of the County of Lycoming, Pennsylvania, and in the Recorder's Office of the County of Tioga, Pennsylvania, encumbering premises at RR3 Shumway Road, Wellsboro, Pennsylvania ("Wellsboro Premises") and 1501 West 3rd Street, Williamsport, Pennsylvania ("Williamsport Premises")
2. UCC-1 financing statements between the Borrower, as debtor, and the Agent, as Agent for the Banks, as secured party, to be filed in the Real Estate Records of Lycoming County, Pennsylvania, in the Real Estate Records of Tioga County, Pennsylvania, and with the Secretary of the Commonwealth of Pennsylvania
3. Policy of title insurance issued by Lawyers Title Insurance Corporation for the Wellsboro Premises and the Williamsport Premises
4. Survey affidavit for the Wellsboro Premises
5. Survey affidavit for the Williamsport Premises
6. Title affidavit for the Wellsboro Premises
7. Title affidavit for the Williamsport Premises
8. The Borrower's letter affirming the provisions of Section 5.4 and Section 6.20 of the Agreement with respect to Assignment of Lessee's Interest in Lease by the Borrower to the Agent, dated as of September 11, 2000, with respect to its lease of premises 3607 West 4th Street, Williamsport, Pennsylvania

#### **B. Real Estate Collateralization Documents**

1. Amended and Restated Deed of Trust by the Borrower to Lawyers Title Insurance Corporation, as Trustees for the Agent, for the benefit of the Banks as beneficiaries to be recorded in the Office of the Register of Deeds of Richmond County, North Carolina, with respect to premises at 395 Ledbetter Road, Rockingham, North Carolina ("Rockingham Premises")
2. UCC-1 financing statements between Borrower, as debtor, and the Agent for the benefit of the Banks, as secured party, to be filed with the Register of Deeds of Richmond County, North Carolina, and with the Secretary of State of the North Carolina.

3. Policy of title insurance issued by Lawyers Title Insurance Corporation for the Rockingham Premises

4. Survey affidavit for the Rockingham Premises

5. Title affidavit for the Rockingham Premises



**Schedule 6.1: Corporate Existence and Ownership**

Delta Galil Industries, Ltd.

## **Schedule 6.5: Equipment and Inventory Locations**

### Borrower Locations:

1501 West Third Street  
Williamsport, Pennsylvania 17701

3607 West Fourth Street  
Williamsport, Pennsylvania 17701

Shumway Hill Road & Route 6  
Wellsboro, Pennsylvania 16901

1000 First Street  
Harrison, New Jersey 07029

800 First Street  
Harrison, New Jersey 07029

395 Ledbetter Road  
Rockingham, North Carolina 28379  
(Equipment only)

150 Meadowlands Parkway  
Secaucus, New Jersey 07096  
(Contents only)

Zip Buena Vista Processing Zone  
San Pedro Sula  
Honduras, C.A.

### Auburn Locations:

113 South Main Street  
Auburn, Kentucky 42206

502 West Gallatin Street  
Adairville, Kentucky 42202  
(Equipment only)

G&G Contracting  
4811 Airport Road  
Fr. Payne, Alabama  
(Equipment only)

Calceta Aerobicas, S.A. de C.V. (Contractor)

Calzada Las Armas #123-E  
Fraccionamiento Industrial Las Armas  
Tlalnepantla, Estado de Mexico  
Mexico C.P. 54080  
(Equipment only)

Burlen Locations:

1905 McCormick Drive  
Tifton, Georgia 31794

26 Forstmann Drive  
Tifton, Georgia 31794

6 East 32nd Street  
New York, New York 10010

Union Textile International, S.A  
Zona Franca Industrial de Esperanza  
Esperanza, Dominican Republic

Quick Manufacturing  
Zona Franca Hainamoza #8  
Santo Domingo, Dominican Republic

### **Schedule 6.6: Corporate Names**

Auburn currently operates under the fictitious names Wilson Sports Socks and Converse Accessories.

**Schedule 6.11: Intellectual Property: Patents, Trademarks, Copyrights and Licenses**

**Patents, Patent Applications, Copyrights**

None.

**Trademarks and Licensed Marks of Borrower**

<u>REGISTRATION NO.</u>	<u>DATE</u>	<u>MARK</u>
1,475,978		HANG UPS
181,556		KICK-A-WAY
1,322,278		KICK-A-WAY
1,186,905		LOVEPATS
1,207,348		LOVEPATS LOGO
1,290,229		UNDERWEAR-ABLES
870,132		KICKAWAY
582,953		WUNDIES
78342307		FLEXIFIT
78203532		SMART SEAMLESS
76392753		BODY FORCE
76299812		OUT OF SIGHT
2657385		THE COMFORT PANTY
2669868		SHORT JANES
2572049		GIRL TALK
2293495		LONG JANES
2395949		MODERN LACE
2248301		SHEER ROMANCE
2410997		SECRET DESIRE
2250251		SHEER DREAMS
1882310		SECRET IMAGES
1835500		HIDDEN SECRETS
1912577		SILK SECRETS
1807616		INNER SECRETS
1935700		SECRETS
1475111		MY BEST FITTING BRA
1280796		SECRETLY YOURS
1325951		SECRETLY YOURS

## FOREIGN TRADEMARKS<sup>2</sup>

The company is allowing foreign trademarks to expire due to non-use. No representation is made to the validity of foreign marks.

<u>COUNTRY</u>	<u>REGISTRATION NO.</u>	<u>DATE</u>	<u>MARK</u>
Bangladesh	38709 (Application No.)		LOVEPATS Logo
Canada	22838		KICKAWAY
Canada	126539		WUNDIES
Chile	442735		PATCHES
China	753566		LOVEPATS Logo
France	1633578		LOVEPATS Logo
Germany	2005217		LOVEPATS Logo
Great Britain	1450555		LOVEPATS Logo
Hungary	140931		LOVEPATS Logo
Italy	663228		LOVEPATS Logo
Mexico	445742		LOVEPATS Logo
Mexico	466403		PATCHES
Poland	88633		LOVEPATS Logo
Romania	21675		LOVEPATS Logo
Spain	1790442		LOVEPATS Logo
Turkey	148441		LOVEPATS Logo

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<sup>2</sup> The Dialogue intellectual property database does not include trademark information for the following countries, and therefore, marks in these countries that are listed on this Schedule cannot be confirmed by publicly available means: Bangladesh, Chile, China, Hungary, Mexico, Poland, Romania and Turkey.

LICENSED TRADEMARKS

Barbie	Danskin
Polly Pocket	Freestyle
Disneys' Properties	Danskin NOW
PowerPuff Girls	Maidenform
Looney Tunes	Sweet Nothings
Yo Girl!	Nicole Miller
Earth 2 Jane	Starter
Fred Is Red	Jeffrey Fulvimari
Miffy & Friends	
Rainbow Brite	
Maya & Miguel	

LOGOS

Please see Annex B attached.

Trademarks of Auburn

<u>REGISTRATION NO.</u>	<u>DATE</u>	<u>MARK</u>
1324675		SHEER ECSTASY
1369090		LIGHT FANTASTICS

Licensed Marks of Auburn

- Wilson (script) and “W” (script)
- Converse, All Star and the “Star and Chevron” design

Trademarks of Burlen

<u>REGISTRATION NO.</u>	<u>DATE</u>	<u>MARK</u>
1133137		SECRET SKIN
0565254		“BE-FREE”
78448451 <sup>3</sup>		JUST RELAX

Licensed Marks of Burlen

- License Agreement dated as of July 2, 2003 between Stony Apparel Corporation and Burlen granting a license to Eye Shadow™. In the opinion of management of the Borrower and Burlen, this license is de minimis and licensor consent to assignment of such mark shall not be obtained.

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<sup>3</sup> This is the Serial Number for the Just Relax trademark, not the Registration Number. The Application for Registration was submitted on July 9, 2004 and a Registration Number has not yet been assigned.



### **Schedule 6.17: Subsidiaries**

Secretly Yours Ltd. (HK)*:	(100 % owned by Borrower)
Secret Images Ltd. (HK)*:	50% owned by Borrower and 50% owned by Secretly Yours Ltd. (HK))
Secrets Ltd. (HK)*	50% owned by Borrower and 50% owned by Secretly Yours Ltd. (HK))
Wundies Inc. (NY) <sup>+</sup>	(100% owned by Borrower)

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\* Acts solely as purchasing agent.

<sup>+</sup> Wundies Inc. is inactive and is currently in the process of being dissolved.

### **Schedule 6.18: Litigation and Proceedings**

1. Ziari, LLC (“Ziari”) v. Kobra Int'l Ltd. (“Kobra”), Delta Galil Industries Ltd., Delta Galil USA Inc. (“Borrower”), and Delta Textiles New York, Ltd (collectively, the “Delta Companies”).  
This action was commenced against the Delta Companies in October 2004 in the Supreme Court, New York County. The Delta Companies must serve their answer by December 20, 2004. The complaint alleges tortious interference by the Delta Companies with Ziari's contractual and economic relations with Kobra. The complaint seeks "an amount to be determined at trial but believed to be in excess of \$100,000" in compensatory damages and \$5 million in punitive damages. Currently, the Delta Companies are engaged in settlement discussions with Ziari and Kobra and anticipate a quick settlement requiring no monetary payments by Delta Companies.
2. Ames Merchandising Corp. v. Wundies Inc.  
This is an adversary proceeding instituted in October 2003 in connection with the Ames Department Stores, Inc. Chapter 11 proceeding pending in the United States Bankruptcy Court for the Southern District of New York (the "Ames Chapter 11 Case"). The complaint alleges preference payments owed by Wundies Inc. in the amount of \$45,864.00. Wundies Inc. served an Answer in January 2004 denying the claim.
3. Ames Merchandising Corp. v. Wundies Enterprises, Inc., d/b/a Kickaway  
This is an adversary proceeding instituted in October 2003 in connection with the Ames Chapter 11 Case. The complaint alleges preference payments owed by Wundies Inc. in the amount of \$147,541.53. Wundies Inc. served an Answer in January 2004 denying the claim.
4. Ames Merchandising Corp. v. Wilson Sport Socks Co. (“Wilson Socks”)  
This is an adversary proceeding instituted in October 2003 in connection with the Ames Chapter 11 Case. (Wilson Sport Socks Co. is a trade name used by Auburn Hosiery Mills, Inc.) The complaint alleges preference payments owed by Wilson Socks in the amount of \$113,069.32. Due to questions about the validity of service of the complaint, Wilson Socks is presently in process of agreeing on a due date for its Answer.

## **Schedule 6.19: Environmental Matters**

1. The Premises located at 26 Forstmann Road, Tifton, Georgia, was the subject of past releases of Hazardous Substances by former owners and/or operators of the property, and was previously listed on the Georgia Hazardous Site Inventory as Site #10473, pursuant to the Georgia Hazardous Site Response Act. Measurable levels of Hazardous Substances are still present at the property. During the investigation and ultimate removal of the Forstmann Road property from the Hazardous Site Inventory, various governmental approvals were received by Burlen from the Georgia Environmental Protection Division regarding the Forstmann Road property. Burlen has entered into communications and agreements with the Tift County Development Authority, Forstmann & Company and J.P. Stevens with respect to liability for cleanup costs at the Forstmann Road property. At one time, at least two underground storage tanks were present on the Forstmann Road property, but were purportedly removed by a previous owner of the property.

A history of the remediation of the Fortsmann Road property is listed below:

- Phase I Environmental Site Assessment, July 18, 1996, Consultech Engineering;
- Phase II Soil Assessment Report, February 28, 1997, Consultech Engineering;
- Report of Source Investigation and Ground-Water Sampling and Analysis, April 8, 1997, LAW Engineering;
- Indemnity Agreement with Tift County Development Authority, July 18, 1997;
- Letter from Law Engineering to EPD, Regarding Submittal of Additional Information Concerning the HSRA Reporting Requirements, August 22, 1997;
- Letter from EPD to Burlen Corporation, Regarding Compliance Status Report Call-In, December 21, 1998;
- Compliance Status Report, June 21, 1999, submitted on behalf of Forstmann & Company by LAW Engineering;
- EPD Notice of Deficiency, October 15, 1999 to Forstmann & Company, Inc.;
- Notice of Forstmann Bankruptcy to EPD, December 15, 1999;
- CSR Call-In Letter to Burlen Corp., December 22, 1999;
- Letter from Troutman Sanders to Larry Kloet, EPD, Regarding CSR, January 19, 2000;
- CSR Call-In Letter to J.P. Stevens, March 1, 2000;
- EPD Letter Re: Proposed Consent Order to J.P. Stevens, April 17, 2000;
- Letter to EPD Re: Extension of Deadline for Submission of Revised CSR, May 17, 2000;
- EPD Letter Re: Administrative Order to J.P. Stevens, June 2, 2000;
- Revised Compliance Status Report and Corrective Action Plan, August 2000, submitted on behalf of Burlen Corp. by LAW Engineering;
- EPD Notice of Deficiency, December 18, 2000;
- EPD HSRA File Information, 1997-2000;
- Agreement Between Burlen Corp. and J.P. Stevens, February 6, 2001;
- Revised Compliance Status Report, May 2001, submitted on behalf of Burlen Corp. and J.P. Stevens, Inc. by LAW Engineering;

- Letter from Law Engineering to EPD, Regarding Milestone Schedule, May 25, 2001;
- Letter from Law Engineering to EPD, Regarding Revised CSR Tables, July 19, 2001;
- EPD Concurrence With Compliance Status Report, August 28, 2001;
- Letter from Law Engineering to Troutman Sanders, Regarding Results of Treatability Studies, August 31, 2001;
- Letter from Law Engineering to EPD, Regarding Re-Calculation of Type 4 Risk Reduction Standards, October 12, 2001;
- Letter from EPD, Regarding Type 4 RRS Site Specific Calculation, January 9, 2002;
- Letter from Law Engineering to EPD, Regarding Request for Meeting, January 22, 2002;
- Letter from Law Engineering to EPD, Following Up on Meeting, January (SIC – February) 20, 2002;
- Letter from Troutman Sanders to EPD, Regarding Recording Deed of Notice, January 23, 2002;
- Re-Certification and Continued Monitoring Plan, October 4, 2002, submitted on behalf of Burlen Corp. and J.P. Stevens, Inc. by MACTEC Engineering;
- Letter from EPD, Regarding CAP Notice of Deficiency, December 19, 2002;
- Response to Comments, February 18, 2003, MACTEC Engineering;
- EPD Letter Re: Response to CAP NOD, April 9, 2003;
- Revised Re-Certification and Continued Monitoring Plan, May 9, 2003, submitted on behalf of Burlen Corp. and J.P. Stevens, Inc. by MACTEC Engineering;
- Notice to MACTEC Engineering of WestPoint Stevens and J.P. Stevens Bankruptcy;
- EPD Letter Re: Approval of CAP, June 27, 2003;
- EPD Proposed Consent Order to Burlen Corp., August 20, 2003;
- Annual Site Reconnaissance Report, September 11, 2003, MACTEC Engineering;
- Response to EPD Proposed Consent Order, September 22, 2003;
- Letter and Financial Assurance Documentation to EPD, September 22, 2003;
- EPD Letter Re: Removal From Hazardous Site Inventory, October 14, 2003;
- Administrative Order, October 14, 2003;
- 2004 Annual Site Reconnaissance and Groundwater Monitoring Report, June 8, 2004, MACTEC Engineering; and
- September 10, 2004 Memorandum to L.A. Sonny Bowen from Troutman Sanders regarding the environmental status of the Forstmann Road and McCormick Drive facilities.

2. The Real Property located at 1904 McCormick Drive has experienced a release of petroleum from underground storage tanks located on an adjacent property.

A history of the Environmental Complaint of the McCormick Drive property is listed below:

- Phase I Environmental Site Assessment, December 17, 1996, Consultech Engineering;
- Phase II Environmental Site Assessment, December 30, 1996, Consultech Engineering;
- Phase I Environmental Site Assessment, August 9, 1999 [sic, 2000], Consultech Eng.;
- EPD Trip Report for Calhoun Oil Company, February 13, 2002; and
- September 10, 2004 Memorandum to L.A. Sonny Bowen from Troutman Sanders regarding the environmental status of the Forstmann Road and McCormick Drive facilities.

**Schedule 8.1: Liens**

<b>DEBTOR(s)</b>	<b>JURISDICTION</b>	<b>DATE FILED</b>	<b>FILE NUMBER</b>	<b>TYPE OF FILING</b>	<b>SECURED PARTY<sup>4</sup></b>
Burlen Corp	Tift County, Georgia	8/16/2000	Bk 683 Pg 001	Fixture	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	7/8/1994	1371994001196	UCC-1	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	4/20/1999	1371999001025	Amendment (Address)	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	4/20/1999	1371999001026	Continuation of Above	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	8/16/2000	1372000001524	Amendment (Name: Bank of America, N.A.)	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	2/9/2004	1342004000190	Continuation of Above	Bank of America, N.A.
Burlen Corp.	Georgia Cooperative Authority	2/9/2004	1372004000191	Amendment (Address)	Bank of America, N.A.
Burlen Corp.	Georgia Cooperative Authority	12/27/1995	0071995003714	UCC-1	Fuji Photo Film USA, Inc.
Burlen Corp.	Georgia Cooperative Authority	7/20/2000	0072000008732	Continuation of Above	Fuji Photo Film USA, Inc.
Burlen Corp.	Georgia Cooperative Authority	5/2/1997	1371997001089	UCC-1	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	8/16/2000	1372000001525	Amendment (Name: Bank of America, N.A.)	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	1/28/2002	1372002000151	Continuation of Above	Bank of America, N.A.
Burlen Corp.	Georgia Cooperative Authority	4/22/1998	1371998001077	UCC-1	NationsBank, N.A.
Burlen Corp.	Georgia Cooperative Authority	8/16/2000	1372000001523	Amendment (Name: Bank of America, N.A.)	NationsBank, N.A.

<sup>4</sup> The obligations securing all lien filings listed in this Schedule 8.1 with Bank of America, N.A. and/or NationsBank, N.A. as secured party are being paid off at closing, and termination statements therefor shall be filed shortly thereafter, except with respect to the first filing listed (Bk 683 Pg 001 filed in Tift County, Georgia).

## Schedule 8.2 Indebtedness

- Industrial Revenue Bonds in the amount up to \$3,043,158 backed up by a Stand-by Letter of Credit in the amount of up to \$3,043,158 issued to Wells Fargo Bank Minnesota, N.A. f/k/a Norwest Bank Minnesota, N.A., to be secured by cash collateral deposited with Bank of America, N.A. on the Closing Date
- Various Trade Letters of Credit all expiring no later than April 30, 2005 in the amount of \$1,424,425,50 to be secured by cash collateral deposited with Bank of America, N.A. on the Closing Date
- Letter of Credit issued to the State of Georgia for worker's compensation expiring on May 1, 2005 in the amount of \$280,000 to be secured by cash collateral deposited with Bank of America, N.A. on the Closing Date
- Earn-out payments payable to Section 1.4 of the Stock Purchase Agreement dated as of the date hereof among Steven Klein, Kristina Nettesheim, Gary Beggs, Delta Galil and the Borrower
- Contingent payments payable pursuant to Sections 7.12 and 7.13 of the Stock Purchase Agreement dated as of the date hereof among Steven Klein, Kristina Nettesheim, Gary Beggs, Delta Galil and the Borrower
- Intercompany loan in the amount of \$10,000,000 made by Delta Galil to the Borrower

**Schedule 8.14: Employer Benefit Plans**

1. Delta Galil USA Employees Profit Sharing and Savings Plan (f/k/a Wundies Employees Profit Sharing and Savings Plan)
2. Wundies Employee Defined Benefit Pension Plan (all benefits were frozen as of 1996)
3. Burlen Corporation Employees Profit Sharing and Savings Plan (401K)

**List of Significant Subsidiaries**

<b>Company</b>	<b>Place of Incorporation</b>	<b>Ownership Interest</b>
Delta Galil USA. Inc.	Delaware, U.S.A.	100%
Auburn Hosiery Mills Inc.	USA	100%
Burlen Corporation	USA	100%
Delta Galil Europe Ltd.	U.K.	100%
Delta Galil Holland B.V.	Holland	100%
Delta Textile Egypt - Free Zone S.A.E.	Egypt	100%
Century Wear Corporation (WLL)	Jordan	50%(1)
Dominion Hosiery Inc.	Canada	100%
Sport Socks Co. Ltd	Ireland	100%
Delta Textile Marketing Ltd.	Israel	100%
Delta Textile (New York) Ltd.	New York, U.S.A.	100%

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



**CERTIFICATIONS**

I, Arnon Tiberg, certify that:

- (1) I have reviewed this annual report on Form 20-F of Delta Galil Industries Ltd.;
- (2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this I report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - (a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- (6) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuers internal control over financial reporting.

Date: June 27, 2005

/s/ Arnon Tiberg  
Chief Executive Officer

EXHIBIT 12.2

I, Yossi Hajaj, certify that:

- (1) I have reviewed this annual report on Form 20-F of Delta Galil Industries Ltd.;
- (2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - (a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- (6) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: June 27, 2005

/s/ Yossi Hajaj  
Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Delta Galil Industries Ltd. (the "Company") on Form 20-F for the period ending December 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 27, 2005

/s/ Arnon Tiberg  
Name: Arnon Tiberg  
Title: Chief Executive Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Delta Galil Industries Ltd. (the "Company") on Form 20-F for the period ending December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 27, 2005

/s/ Yossi Hajaj  
Name: Yossi Hajaj  
Title: Chief Financial Officer

EXHIBIT 14.1

PRICEWATERHOUSECOOPERS

KESSELMAN & KESSELMAN  
TRADE TOWER, 25 HAMERED STREET  
TEL AVIV 68125,  
ISRAEL  
TEL: +-972-3-7954555  
FAX: +-972-3-7954556

June 27, 2004

The Board of Directors  
Delta Galil Industries Ltd.

We consent to the use in the Annual Report on Form 20-F of Delta Galil Industries Ltd. filed with the United States Securities and Exchange Commission, of our report dated June 27, 2005 on the consolidated balance sheets of Delta Galil Industries Ltd. and its subsidiaries as at December 31, 2004 and the consolidated statements of income, retained earnings and changes in financial position for the years ended December 31, 2004, 2003 and 2002 and to the incorporation by reference of such report into the Registration Statements on Form S-8 of Delta Galil Industries Ltd. (Registration Nos. 333-12608, 333-13716 and 333-102247).

/s/ Kesselman & Kesselman

Kesselman & Kesselman

Our ref: APO/NDW/cp/129968  
Your ref:

**BAKER TILLY**

2 Bloomsbury Street  
London WC1B 3ST  
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Fax: +44(0)20 7413 5101  
DX: 1040 London/Chancery Lane  
[www.bakertilly.co.uk](http://www.bakertilly.co.uk)

The Board of Directors  
Delta Galil Industries Limited  
Textile House  
2 Kaufman Street  
Tel Aviv 68012  
Israel

15 June 2005

Dear Sirs

**DELTA TEXTILES (LONDON) LIMITED  
YEAR ENDED 31 DECEMBER 2004  
CONSENT OF INDEPENDENT ACCOUNTANTS**

We consent to the use in the Annual Report on Form 20-F of Delta Galil Industries Limited filed with the United States Securities and Exchange Commission, of our report dated 15 June 2005 on the consolidated balance sheets of Delta Textiles (London) Limited and its subsidiaries as at 31 December 2004 and the consolidated statements of income, retained earnings and changes in financial position for the years ended 31 December 2004, 2003 and 2002 and to the incorporation by reference of such report into the Registration Statements on Form S-8 of Delta Galil Industries Limited (Registration Nos. 333-12608, 333-13716 and 333-102247).

Yours faithfully

/s/ Baker Tilly

Baker Tilly

ERNST & YOUNG ALLIED FOR ACCOUNTING & AUDITING Phone: +20 2 336 2000  
37 El Ahrar Street, Mobica Tower Fax: +20 2 760 0813  
P.O. Box 97 Dokki, Giza-Egypt  
CAIRO.OFFICE@EG.EY.COM

June 15, 2005

The Board of Directors  
Delta Galil Industries Ltd.

We consent to the use in the Annual Report on Form 20-F of Delta Galil Industries Ltd. filed with the United States Securities and Exchange Commission, of our report dated June 15, 2005 on the consolidated balance sheets of Delta Sourcing Egypt (L.L.C.) as at December 31, 2004 and the consolidated statements of income, retained earnings and changes in financial position for the years ended December 31, 2004, 2003 and 2002 and to the incorporation by reference of such report into the Registration Statements on Form S-8 of Delta Galil Industries Ltd. (Registration Nos. 333-12608, 333-13716 and 333-102247).

EMAD H. RAGHEB  
FFSAA - FEST  
(RAA - 3678)

CAIRO 15 June 2005

ERNST & YOUNG ALLIED FOR ACCOUNTING & AUDITING Phone: +20 2 336 2000  
37 El Ahrar Street, Mobica Tower Fax: +20 2 760 0813  
P.O. Box 97 Dokki, Giza-Egypt  
CAIRO.OFFICE@EG.EY.COM

The Board of Directors  
Delta Galil Industries Ltd.

We consent to the use in the Annual Report on Form 20-F of Delta Galil Industries Ltd. filed with the United States Securities and Exchange Commission, of our report dated June 15, 2005 on the consolidated balance sheets of Delta Textile Egypt (S.A.E.) as at December 31, 2004 and the consolidated statements of income, retained earnings and changes in financial position for the years ended December 31, 2004, 2003 and 2002 and to the incorporation by reference of such report into the Registration Statements on Form S-8 of Delta Galil Industries Ltd. (Registration Nos. 333-12608, 333-13716 and 333-102247).

EMAD H. RAGHEB  
FFSAA - FEST  
(RAA - 3678)

CAIRO 15 June 2005



**DELTA GALIL INDUSTRIES LTD.**  
(An Israeli corporation)  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2004

**DELTA GALIL INDUSTRIES LTD.**  
(An Israeli corporation)  
CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2004

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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, 2004 and 2003 and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose assets included in consolidation constitute approximately 12% and 18% of total consolidated assets as of December 31, 2004 and 2003, respectively, and whose revenues included in consolidation constitute approximately 0%, 2% and 10% of total consolidated revenues for the years ended December 31, 2004, 2003 and 2002, respectively. The financial statements of those subsidiaries were audited by other independent registered public accounting firms, whose reports have been furnished to us, and our Opinion, insofar as it relates to amounts included for those companies, is based on the reports of the other independent registered public accounting firms.

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

In our opinion, based on our audits and the reports of the other independent registered public accounting firms, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Tel-Aviv, Israel  
June 27, 2005

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

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

**CONSOLIDATED STATEMENTS OF INCOME**

(U.S. dollars in thousands, except earnings per share)

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Net revenues</b>	\$654,269	\$580,130	\$567,298
<b>Cost of revenues</b>	533,036	463,863	454,211
<b>Gross profit</b>	121,233	116,267	113,087
<b>Selling, marketing, general and administrative expenses - net</b>	98,646	82,089	84,162
<b>Gain (loss) on sale of assets and subsidiary shares</b>	922	3,645	(92)
<b>Restructuring expenses</b>	1,100	1,007	1,065
<b>Operating income</b>	22,409	36,816	27,768
<b>Financial expenses - net</b>	6,231	5,637	5,456
<b>Other income - net</b>	958	252	960
<b>Income before taxes on income</b>	17,136	31,431	23,272
<b>Taxes on income</b>	2,846	7,340	5,779
	14,290	24,091	17,493
<b>Share in profits (losses) of associated companies - net</b>	(237)	(300)	158
<b>Minority interests, net</b>	(1,368)	(439)	(1,025)
<b>Net income</b>	<u>\$12,685</u>	<u>\$23,352</u>	<u>\$16,626</u>
<b>Earnings per share:</b>			
Basic	<u>\$0.69</u>	<u>\$1.28</u>	<u>\$0.88</u>
Diluted	<u>\$0.67</u>	<u>\$1.24</u>	<u>\$0.88</u>
<b>Weighted average number of shares (in thousands):</b>			
Basic	<u>18,478</u>	<u>18,313</u>	<u>18,914</u>
Diluted	<u>18,834</u>	<u>18,763</u>	<u>18,927</u>

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

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

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
<b>A s s e t s</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$22,150	\$ 17,699
Accounts receivable:		
Trade	105,129	85,723
Other	10,627	10,662
Inventories	183,767	142,984
Deferred income taxes	3,675	5,464
Other investment , see note 3		1,682
T o t a l current assets	325,348	264,214
<b>Investments and long-term receivables:</b>		
Associated company	455	661
Funds in respect of employee rights upon retirement	6,852	6,161
Long-term receivables, net of current maturities	226	419
	7,533	7,241
<b>Property, plant and equipment,</b>		
net of accumulated depreciation and amortization	128,341	124,877
<b>Goodwill</b>		
	57,920	54,358
<b>Intangible asset</b>		
	14,778	
<b>Deferred charges, net of accumulated amortization</b>		
	577	194
T o t a l assets	\$534,497	\$ 450,884

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**D. Lautman**  
**Chairman of the Board**

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**A. Tiberg**  
**CEO**

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**G. Morag**  
**Director**

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

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities:</b>		
Short-term bank credit	\$55,603	\$94,560
Current maturities of long-term bank loans and other liability	27,942	10,436
Accounts payable and accruals:		
Trade	80,338	54,464
Other	34,083	48,142
	197,966	207,602
<b>Long-term liabilities:</b>		
Bank loans and other liability, net of current maturities	99,437	14,709
Liability for employee rights upon retirement	7,408	6,732
Deferred income taxes	4,894	6,300
	111,739	27,741
<b>Commitments and contingent liabilities, see note 9</b>		
	309,705	235,343
<b>Minority interests</b>		
	3,711	3,207
<b>Shareholders' equity:</b>		
Ordinary shares of NIS 1 par value		
December 31, 2004 and 2003:		
Authorized - 26,000,000 shares;		
Issued - 19,947,849 shares;		
Issued and paid - 19,901,967 shares and 19,860,211 shares,		
respectively	21,840	21,830
Additional paid-in capital	100,749	99,735
Retained earnings	108,980	104,607
Accumulated other comprehensive loss	(788)	(2,503)
Treasury shares, at cost (1,206,802 shares and 1,422,486 shares, in December 31, 2004 and 2003, respectively)	(9,700)	(11,335)
	221,081	212,334
<b>T o t a l shareholders' equity</b>	<b>221,081</b>	<b>212,334</b>
<b>T o t a l liabilities and shareholders' equity</b>	<b>\$534,497</b>	<b>\$450,884</b>

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

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

	Share capital		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury shares, at cost	Total
	Number of shares	Par value					
	In thousands						
<b>BALANCE AT JANUARY 1, 2002</b>	19,678	21,792	98,014	81,098	225	(2,940)	\$198,189
<b>CHANGES DURING 2002:</b>							
Net income				16,626			16,626
Losses in respect of derivative instruments designated as a cash-flow hedge (net of related taxes of \$363,000)					(808)		(808)
Differences from translation of foreign currency financial statements					*		*
Additional minimum pension liability adjustment (net of related taxes of \$540,000)					(823)		(823)
Total comprehensive income							14,995
Exercise of employee stock options	2	*	16				16
Cash dividend (\$0.37 per share)				(6,976)			(6,976)
Cost of acquisition of treasury shares						(8,395)	(8,395)
<b>BALANCE AT DECEMBER 31, 2002</b>	<u>19,680</u>	<u>\$21,792</u>	<u>\$98,030</u>	<u>\$90,748</u>	<u>\$(1,406)</u>	<u>\$(11,335)</u>	<u>\$197,826</u>
<b>CHANGES DURING 2003:</b>							
Net income				23,352			23,352
Losses in respect of derivative instruments designated as a cash-flow hedge (net of related taxes of \$474,000)					(1,134)		(1,134)
Differences from translation of foreign currency financial statements					*		*
Additional minimum pension liability adjustment (net of related taxes of \$25,000)					37		37
Total comprehensive income							22,255
Exercise of employee stock options	181	38	1,387				1,425
Tax benefit in respect of employee stock options exercised			318				318
Cash dividend (\$0.52 per share)				(9,493)			(9,493)
<b>BALANCE AT DECEMBER 31, 2003</b>	<u>19,861</u>	<u>\$21,830</u>	<u>\$99,735</u>	<u>\$104,607</u>	<u>\$(2,503)</u>	<u>\$(11,335)</u>	<u>\$212,334</u>
<b>CHANGES DURING 2004:</b>							
Net income				12,685			12,685
Gains in respect of derivative instruments designated as a cash-flow hedge (net of related taxes of \$798,000)					1,715		1,715
Differences from translation of foreign currency financial statements					45		45
Additional minimum pension liability adjustment (net of related taxes of \$30,000)					(45)		(45)
Total comprehensive income							14,400
Exercise of employee stock options	41	10	321				331
Tax benefit in respect of employee stock options exercised			79				79
Reissuance of treasury shares on acquisition of Burlen (see note 2a)			614			1,635	2,249
Cash dividend (\$0.45 per share)				(8,312)			(8,312)
<b>BALANCE AT DECEMBER 31, 2004</b>	<u>19,902</u>	<u>\$21,840</u>	<u>\$100,749</u>	<u>\$108,980</u>	<u>\$(788)</u>	<u>\$(9,700)</u>	<u>\$221,081</u>

\* Less than \$1,000.

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

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

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$12,685	\$23,352	\$16,626
Adjustments to reconcile net income to net cash provided by operating activities:			
Income and expenses not involving cash flows:			
Minority interests in profits of subsidiaries - net	1,368	439	1,025
Share in losses (profits) of associated companies, net	237	300	(158)
Amounts carried to deferred charges	(597)		(146)
Depreciation and amortization	15,185	14,530	14,082
Write-down of other investments		634	
Deferred income taxes - net	(279)	(3,555)	440
Restructuring expenses	1,310	194	414
Changes in accrued liability for employee rights upon retirement	1,023	409	96
Loss (gain) on amounts funded in respect of employee rights upon retirement	(416)	214	624
Capital loss (gain) on sale of property, plant and equipment and subsidiary shares	(922)	(3,645)	313
Capital gain from realization of other investment	(958)	(885)	(960)
Erosion of long-term receivables	(6)	(30)	
Exchange differences (erosion) of principal of long-term bank loans - net	(180)	1,043	28
	<u>15,765</u>	<u>9,648</u>	<u>15,758</u>
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable	1,798	15,095	(10,493)
Increase (decrease) in accounts payable and accruals	17,004	(5,061)	4,425
Increase in inventories	(20,078)	(173)	(35)
	<u>(1,276)</u>	<u>9,861</u>	<u>(6,103)</u>
Net cash provided by operating activities – forward	<u>\$27,174</u>	<u>\$42,861</u>	<u>\$26,281</u>



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

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Brought forward	\$27,174	\$42,861	\$26,281
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Acquisition of subsidiaries <sup>(1)</sup>	(56,039)	(10,101)	(5,600)
Payments related to restructuring costs	(4,800)		
Additional payment allocated to goodwill	(6,700)	(2,003)	
Purchase of property, plant and equipment	(13,484)	(14,925)	(17,728)
Investment grants relating to property, plant and equipment	1,074	1,099	1,591
Other investments	(58)		(17)
Proceeds from sale of property, plant and equipment	4,318	6,091	494
Proceeds from realization of other investment	2,640	2,567	2,480
Proceeds from sale of subsidiary shares		250	
Associated company consolidated in previous years <sup>(2)</sup>			(2)
Loans granted to employees	(260)	(350)	(408)
Collection of employees loans	313	345	400
Long term loans granted	(26)	(221)	(270)
Amounts funded in respect of employee rights upon retirement – net	(667)	(1,157)	(686)
Net cash used in investing activities	<u>(73,689)</u>	<u>(18,405)</u>	<u>(19,746)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Cost of acquisition of treasury shares			(8,356)
Long-term bank loans and other long-term liabilities	119,000		11,000
Decrease in long-term loans and other long-term liabilities	(10,430)	(10,335)	(10,391)
Dividend to the Company's shareholders	(8,312)	(9,493)	(6,976)
Dividend to minority shareholders in a subsidiary	(863)	(778)	(500)
Short-term bank credit – net	(48,890)	(2,067)	10,401
Proceeds from exercise of options granted to employees and the company's CEO	331	1,425	16
Net cash provided by (used in) financing activities	<u>50,836</u>	<u>(21,248)</u>	<u>(4,806)</u>
<b>TRANSLATION DIFFERENCES ON CASH AND CASH EQUIVALENTS OF FOREIGN CURRENCY CONSOLIDATED SUBSIDIARY</b>	130	*	
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	4,451	3,208	1,729
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	17,699	14,491	12,762
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$22,150</u>	<u>\$17,699</u>	<u>\$14,491</u>

\* Less than \$1,000.

(1), (2) See next page for details.

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

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>SUPPLEMENTARY DISCLOSURE OF CASH FLOW INFORMATION - CASH PAID DURING THE YEAR FOR:</b>			
Interest	\$4,133	\$3,660	\$3,870
Income taxes	\$3,169	\$9,478	\$6,748
<b>(1) Acquisition of subsidiaries, see also note 2:</b>			
Assets and liabilities of the subsidiaries upon acquisition:			
Working capital (excluding cash and cash equivalents)	\$29,944	\$2,091	\$500
Long-lived assets	9,636	6,642	4,347
Intangible asset	14,778		
Goodwill arising on acquisition	4,930	1,368	753
	59,288	10,101	5,600
Reissuance of treasury shares	2,249		
Amount payable	1,000		
Cash paid – net	\$56,039	\$10,101	\$5,600
<b>(2) Associated company previously consolidated:</b>			
Assets and liabilities of the subsidiary previously consolidated			
Working capital (excluding cash and cash equivalents)			\$657
Fixed assets			(2,511)
Long-term liabilities			435
Minority interest in subsidiaries			711
Investments in an associated company			710
			\$2

**Supplementary information on investing activities not involving cash flows:**

In 2004, 2003 and 2002, the net changes in outstanding balances of trade payables in respect of the purchase of property, plant and equipment were an increase (decrease) of \$ 0.1 million, \$(1.1) million and \$ 0.2 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 five reportable operating segments – Delta USA, U.S. upper market, Europe, Socks and Delta marketing Israel. As to the Group’s segments and principal markets see note 15.

A significant portion of the Group’s revenues derives from three principal customers. See note 12a and 15c.

2) Accounting principles

The consolidated financial statements are prepared in accordance with generally accepted accounting principles (“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 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.

## **DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The functional currency of a subsidiary which was acquired in 2003 (see also note 2c) and an associated company is its local currency (EURO and NIS). The financial statements of this subsidiary are included in consolidation based on translation into 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 income (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 statement 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.

#### **c. Cash equivalents**

The Group considers all highly liquid investments, which composed 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.

#### **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 of materials (on the “moving average” basis), labor and an appropriate portion of indirect manufacturing costs.

#### **e. Investments in an associated company**

An “associated company” is a company over which significant influence is exercised, but which is not a consolidated subsidiary. An associated company is accounted for by the equity method.

## DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

##### f. Property, plant and equipment

Property, plant and equipment are stated at cost, net of related investment grants in the amount of \$ 49.8 million and \$ 49.2 million at December 31, 2004 and 2003, respectively. 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 and plumbing	2%-7% (mainly 4%)
Machinery and equipment	7%-25% (mainly 7%)
Vehicles	15%-20% (mainly 15%)
Office furniture and equipment	6%-25% (mainly 7%)

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

##### 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 will perform its annual goodwill impairment test. No impairment resulted from the annual review performed in the year ended December 31, 2004, 2003 and 2002.

##### h. Deferred charges

Deferred charges represent mainly financing charges, which are amortized over the credit period.

Amortization of deferred charges included among "financial expenses ,net" were \$ 353 thousands, \$ 250 thousands and \$ 164 thousands, for the years ended December 31, 2004, 2003 and 2002, respectively.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

**i. Impairment in value of long-lived assets**

Under FAS 144 “Accounting for the Impairment or Disposal of Long-Lived Assets” (“FAS 144”), the Company reviews long-lived assets, 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.

As for long – lived assets impairment, see note 12e.

**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.

As stated in note 11a, a plant of an Israeli subsidiary has been granted “approved enterprise” status and, 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. See note 11a(1)(a).

The Group does not provide for an additional tax liability with respect to the excess of the amount for financial reporting 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.

## **DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

##### **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.

##### **m. Concentration of credit risks – allowance for doubtful accounts**

The Group's cash and cash equivalents as of December 31, 2004 and 2003 were deposited

Mainly with major banks in United States of America, United Kingdom, Hungary and Egypt and in 2003 United States of America, Israel, Hungary 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 sales is to 3 principal customers (see also note 15c). The balance receivables from these principal customers as of December 31, 2004 and 2003 were \$ 47,982 thousands and \$ 51,297 thousands, respectively (see also note 12a). The Group does not hold any collateral from these customers; however, based on past experience with those customers, 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 bad debt income (expenses) and allowance charged to expenses, for the years ended December 31, 2004, 2003 and 2002 aggregated \$ 950 thousands, \$ 309 thousands and \$ (3,558) thousands, 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 income. Shipping and handling costs for the years ended December 31, 2004, 2003 and 2002 were approximately \$ 20 million, \$ 17 million and \$ 18 million, respectively.

##### **o. Advertising costs**

These costs are expensed as incurred. Advertising costs for the years ended December 31, 2004, 2003 and 2002 were \$ 2.1 million, \$ 1.9 million and \$ 2.5 million, respectively.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

##### p. Stock based compensation

Stock options granted to employees are accounted for under the recognition and measurement principles of APB No. 25, “Accounting for Stock Issued to Employees”, and related interpretations. Under APB 25, compensation cost for employee stock option plans is measured using the intrinsic value based method of accounting.

Accordingly, the difference, if any, between the quoted market price of the ordinary shares on the date of grant of the options and the exercise price of such options is amortized by the accelerated amortization method, against income, over the expected service period (up to four years).

FAS 123, “Accounting for Stock-Based Compensation”, established a fair value based method of accounting for employee stock options or similar equity instruments, and encourages adoption of such method for stock compensation plans. However, it also allows companies to continue to account for those plans using the accounting treatment prescribed by APB 25. The Company has elected to continue accounting for employee stock option plans under APB 25, and has accordingly complied with the disclosure requirements set forth in FAS 123, as amended by FAS 148, for companies electing to apply APB 25, (see also note 1t).

The following table illustrates the effect on net income and earnings per share assuming the Company has applied the fair value recognition provisions of FAS 123 to its stock-based employee compensation:

	Year ended December 31		
	2004	2003	2002
	\$ in thousands (except per share data)		
Net income, as reported	\$ 12,685	\$ 23,352	\$ 16,626
Add – stock-based employee compensation expense include in reported net income net of related tax effect			
Less – stock-based employee compensation expense determined under fair value method, net of related tax effect	(690)	(1,384)	(1,359)
Pro forma net income	<u>\$11,995</u>	<u>\$ 21,968</u>	<u>\$ 15,267</u>
Earnings per share:			
Basic – as reported	\$ 0.69	\$ 1.28	\$ 0.88
Basic – pro forma	\$ 0.65	\$ 1.20	\$ 0.81
Diluted – as reported	\$ 0.67	\$ 1.24	\$ 0.88
Diluted – pro forma	\$ 0.64	\$ 1.17	\$ 0.81



## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The fair value of options granted during 2004, 2003 and 2002 was \$452 thousands, \$72 thousands and \$1,700 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:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Dividend yield	3.5%	5%	5%
Expected volatility	28.00%	27.33%	30.94%
Risk-free interest rate	4%	1%	2%
Expected life – in years	4.25	4.25	5.58

#### q. Earnings per share

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

Diluted earnings per share are computed by dividing net income 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.

#### r. Derivatives

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

Under FAS 133 “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 “Gains or losses in respect of derivative instruments designated as a cash-flow hedge, net of related tax” 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 in income among financial expenses. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognized in 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.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

##### s. Comprehensive income

In addition to net income, other comprehensive income (loss) includes gains or losses in respect of derivative instruments designated as cash-flow hedge, net of related taxes, differences from translation of foreign currency financial statements of a subsidiary and an associated company and additional minimum pension liability adjustments, net of related taxes.

##### t. Recently issued accounting pronouncements:

- 1) In December 2004, the Financial Accounting Standards Board (“FASB”) issued the revised Statement of Financial Accounting Standards (“FAS”) No. 123, *Share-Based Payment* (FAS 123R), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company’s equity instruments or that may be settled by the issuance of such equity instruments. This Statement eliminates the ability to account for employee share-based payment transactions using APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement will be effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 (July 1, 2005 for the Company). Early adoption of FAS 123R is encouraged.  
On April 15, 2005, the Securities and Exchange Commission approved a new rule, under which FAS 123R is effective for public companies at the beginning of their next fiscal year that begins after June 15, 2005 (first quarter of 2006 for the company). This Statement applies to all awards granted or modified after the Statement’s effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement’s effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards’ grant-date fair value as previously calculated for the pro-forma disclosure under FAS 123.  
The Company expects that upon the adoption of FAS 123R, it will apply the modified prospective application transition method, as permitted by the Statement. Under such transition method, upon the adoption of FAS 123R, the Company’s financial statements for periods prior to the effective date of the Statement will not be restated  
The impact of this statement on the Company’s results of operations in 2005 and beyond will depend upon various factors, among them the Company’s future compensation strategy.

## **DELTA GALIL INDUSTRIES LTD.**

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

The Company does not expect this Statement to have a material effect on the Company's results of operations in future periods.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB No. 107"). SAB No. 107 provides guidance on the initial implementation of FAS No. 123(R). In particular, the statement includes guidance related to share-based payment awards with non-employees, valuation methods and selecting underlying assumptions such as expected volatility and expected term. It also gives guidance on the classification of compensation expense associated with share-based payment awards and accounting for the income tax effects of share-based payment awards upon the adoption of FAS No. 123(R). The Company is currently assessing the guidance provided in SAB No. 107 in connection with the implementation of FAS No. 123(R).

- 1) In November 2004, the FASB issued FAS No. 151, "Inventory Costs – an amendment of ARB 43, Chapter 4" (FAS 151). This Statement amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. This Statement requires that those items be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This Statement will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005 (January 1, 2006 for the Company). Earlier application of FAS 151 is permitted. The provisions of this Statement shall be applied prospectively. The Company does not expect this Statement to have a material effect on the Company's financial statements or its results of operations.
- 2) In December 2004, the FASB issued FAS No. 153, "Exchanges of Non-monetary Assets – An Amendment of APB Opinion No. 29" (FAS 153). FAS 153 amends APB Opinion No. 29, "Accounting for Non-monetary Transactions" (Opinion 29). The amendments made by FAS 153 are based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the exception for non-monetary exchanges of similar productive assets and replace it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The provisions in FAS 153 are effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 (July 1, 2005 for the Company). Early application of the FAS 153 is permitted. The provisions of this Statement shall be applied prospectively. The Company does not expect the adoption of FAS 153 to have a material effect on the Company's financial statements or its results of operations.

## **DELTA GALIL INDUSTRIES LTD.**

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

- 3) In May 2005, the FASB issued FAS No. 154, “Accounting Changes and Error Corrections”. FAS No. 154 is a replacement of Accounting Principles Board Opinion (“APB”) No. 20 and FASB Statement No. 3. FAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. FAS No.154 also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The Statement carries forward the guidance contained in APB No. 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. FAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (January 1, 2006 for the Company). The Company does not expect this standard to have a material effect on the Company’s financial statements or results of operations.

#### **u. Reclassifications**

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

#### **NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS ACQUISITIONS:**

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 Burlen Inc. (Burlen) – in 2004**

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

The Burlen acquisition is another step in the Company’s strategy to increase its intimate apparel category of the mass market by exploiting the synergies between Burlen’s operations and the Company’s existing activities. This acquisition is expected to strengthen the Company’s position in the 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 would be paid in 2005.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS ACQUISITIONS (continued):**

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

The additional consideration, will be recorded as additional goodwill.

Other intangible asset acquired, which amounted to \$ 14.8 million, represents customer relations and is amortized over a period of 20 years. 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 relations 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	<u>\$69,432</u>
Short-term bank credit	3,038
Accounts payable – trade	4,341
Accounts payable – Other	2,452
Net assets acquired	<u>\$59,601</u>

As to proforma result, see note d below.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):

##### b. Acquisition of manufacturing plant in Thailand (Thailand) - in 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 to pay off debt to the former shareholders. In addition, the Company assumed bank debt of \$0.7 million. The acquired manufacturing facility in Thailand constitute a “business” under EITF 98-3 – “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business”.

The main strategy for 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 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	<u>\$5,389</u>
Short-term bank credit	601
Accounts payable – trade	528
Accounts payable – Other	1,776
Long term debt	131
Net assets acquired	<u><u>\$2,353</u></u>

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):

##### c. Acquisition of Auburn Hosiery Mills (“Auburn”) – in 2003

In November 2003, the Company acquired, through wholly owned subsidiaries from Kellwood inc. (“the seller”) all of the shares of its two private held U.S. and Irish companies, which are engaged in the operations of design, development, manufacture, sourcing, marketing, distribution and sale of socks. The functional currency of the Irish operation is its local currency - the Euro.

The Group paid \$10.8 million in cash to the seller.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The excess of cost of acquisition over the fair value of net assets on acquisition date approximately \$ 1.4 million – was initially allocated to goodwill.

At November 13, 2003 (in thousands)

Cash and cash equivalents	\$699
Account receivable – trade	5,754
Account receivable – other	700
Inventories	9,448
Property, plant, and equipment	6,642
Goodwill	1,368*
Total assets acquired	<u>\$24,611</u>
Short-term bank credit	\$213
Accounts payable	7,435
Accrued expenses - restructuring costs	<u>6,163 *</u>
Net assets acquired	<u>\$10,800</u>

\*In 2003 the Company recorded liabilities in respect of restructuring costs in an amount of \$6.2 million, which includes approximately \$2.2 million for severance pay and related costs and \$ 4.0 million for costs associated with the shut down of certain acquired facilities. An amount of \$4.8 million was paid during 2004, \$2 million related to grants, \$2.3 million related to employees, \$0.1 million related to property, plant and equipment and \$0.4 million related to manufacturing and others.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):

During 2004 the Company finalized the restructuring plan and liabilities in respect of restructuring costs, which results in a decrease of \$1.9 million on the excess of cost of acquisitions over the fair value of net assets on acquisition date. The said decrease was allocated \$ 1.4 million to the goodwill (which off set the entire goodwill initially recognized) and \$ 0.5 million to property, plant and equipment.

- d. Hereafter are certain unaudited pro forma combined income data assuming that the acquisition of Burlen had occurred on January 1, 2004 and 2003, respectively, and the acquisition of Auburn had occurred on January 1, 2003 and 2002, respectively. The unaudited pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisitions of Burlen and Auburn occurred as of January 1, 2004 and 2003, and 2003 and 2002, respectively, nor is it necessarily indicative of future results.

	Year ended December 31		
	2004	2003	2002
	In thousands (Except earnings per share) (Unaudited)		
Net Revenues	\$763,375	\$721,172	\$626,732
Net Income	\$19,853	\$24,664	\$16,079
Earning per share – Basic	\$1.06	\$1.33	\$0.85
Earning per share – Diluted	\$1.04	\$1.30	\$0.85

e. **Acquisition of the operations of Komar Textile Trading Co. Ltd. (“Komar”) – in 2002**

In November 2002 the Company purchased some of the operations of Komar, a privately held Hungarian company. Komar is engaged in production of baby-wear. The purchase price - \$ 5,600 thousands was paid in cash. The excess of cost of acquisition over the fair value of net assets on acquisition date - \$ 753 thousands - was allocated to goodwill, which is included as part of the Europe segment. Goodwill is not deductible for tax purposes.

During the fourth quarter of 2004 the group has decided to close the logistic center, and included \$ 1.5 million restructuring expenses, of which \$ 0.4 million is included in cost of revenues. See also note 12e.

f. **Acquisition of Inner Secrets Inc. (“Inner”) – in 2001**

In January 2001, the Company acquired, through a wholly owned subsidiary - Wundies Industries Inc. (“the acquiring company”), all of the shares of Inner, a privately held U.S. company, which is engaged in the development, production and marketing of ladies’ intimate apparel.



## **DELTA GALIL INDUSTRIES LTD.**

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### **NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):**

The acquisition price was paid as follows: 85% in cash and 15% in Company shares. In addition, the acquisition price was set to be four times Inner's earnings before interest, income taxes, depreciation and amortization ("EBITDA"), subject to certain adjustments, for the year ended December 31, 2000, but after deducting liabilities to banks and other loans as of December 31, 2000.

In addition, in case the EBITDA of both the acquired company and the acquiring company for the year 2002 will be higher than the EBITDA of both companies for the year 2000 by at least \$ 4 million, the sellers will be entitled to an additional cash payment, of an amount not exceeding 50% of the EBITDA of the acquired company for the year 2000 (hereafter - "the performance payment"), in accordance with certain adjustments. In case the sellers' entitlement to full performance payment will not be in accordance with the 2002 results, the sellers will be entitled to receive the rest of the performance payment, in accordance with the agreement, considering the 2003 results. In any case, the sellers will not be entitled to an over-all payment that exceeds the performance payment. Such additional payment will be paid in cash and will be recorded when earned as additional purchase price.

During 2001 the Company paid \$ 48.7 million in cash (including \$ 14.4 million paid to a bank for discharge of a loan) and \$ 5.9 million in 454,020 Company shares, based on a price per share of \$ 13.05.

During 2003 and 2004 the Company paid an additional \$ 2.0 million and \$ 6.7 million in cash, respectively, as an adjustment to the purchase price. The payments were allocated to goodwill.

In 2003 the purchase price was finalized and the total goodwill amount, resulted from the acquisition, was \$ 24.3 million, which is included as part of Delta USA segment. Goodwill is not deductible for tax purposes.

#### **OTHER TRANSACTION:**

##### **Sale of subsidiary's shares**

In August 2002, Delta Galil signed an agreement for the sale of 10% of its wholly-owned subsidiary, in consideration of \$250 thousands.

During March 2003 the Company received the payment, transferred the shares and as a result recognized a gain in an amount of \$ 109 thousands.

According to the agreement the buyer has an option to purchase additional shares of the subsidiary on terms to be agreed at a later stage. The option shall remain in effect for a period of 36 months from the date of agreement.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 3 – OTHER INVESTMENT AND INVESTMENT IN AN ASSOCIATED COMPANY

**a. Sale of investment in Standard Textile Europe Ltd. (“STE”) – other investment**

On August 4, 2000, a subsidiary signed an agreement for the sale of its investment in STE, which was an associated company (till January 2003), for \$ 9 million, which bears interest of LIBOR plus 1.5% per year.

The transaction was carried out in four equal batches, in the years 2004, 2003, 2002 and 2000. The capital gains recorded in the years 2004, 2003 and 2002 were \$958 thousands, \$885 thousands and \$ 960 thousands, respectively, and were classified to “Other Income - net”.

**b. Edomit Ltd. (“Edomit”) - an associated company**

The Company holds 50% of the shares in Edomit. The Company’s investment in Edomit is accounted for by the equity method.

The balance of the investment in Edomit as of December 31, 2004 and 2003 is \$ 455 thousands and \$ 661 thousands, respectively. As of December 31, 2004 and 2003 these balances include a loan in the amount of \$ 446 and \$ 417, respectively. The loan is linked to the Israeli CPI and bears no interest.

#### NOTE 4 – LONG-TERM RECEIVABLES

Long-term receivables represent long-term loans to employees – mainly linked to the Israeli consumer price index (“CPI”) and bearing interest at the rate of 4%.

These balances are mature in the following years after balance sheet dates:

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
First year – current maturities	\$193	\$512
Second year	204	362
Third year	14	36
Fourth year	5	21
Fifth year	3	
	<u>\$226</u>	<u>\$419</u>
	<u>\$419</u>	<u>\$931</u>

**DELTA GALIL INDUSTRIES LTD..**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 5 – PROPERTY, PLANT AND EQUIPMENT:**

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

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Land, buildings and plumbing, see b. below*	\$41,706	\$38,688
Machinery and equipment	134,873	128,050
Vehicles, office furniture and equipment and leasehold improvements	46,729	43,484
	<u>223,308</u>	<u>210,222</u>
Less – accumulated depreciation and amortization	<u>(94,967)</u>	<u>(85,345)</u>
	<u>\$128,341</u>	<u>\$124,877</u>
* Including building leased under capital lease - (see note 1f):		
Cost	\$1,414	\$1,414
Less – accumulated depreciation	<u>409</u>	<u>315</u>
	<u>\$1,005</u>	<u>\$1,099</u>

In 2003 the Group recorded a \$3.5 millions capital gain from sale of real estate in London.

**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.

- c. Investment projects of the Company and its subsidiary have been approved by the Israeli Investment Center, under the Law for the Encouragement of Capital Investments, 1959. The balance of uncompleted investments as of December 31, 2004 aggregates \$ 6.4 million.
- d. Depreciation and amortization in respect of property, plant and equipment totaled \$ 14.8 , \$14.3 and \$ 13.9 million in the year ended December 31, 2004, 2003 and 2002 (excluding impairment of assets relating to restructuring, see note 12e).
- e. As to pledges on assets, see notes 8d and 11a.

**DELTA GALIL INDUSTRIES LTD.**

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 6 – GOODWILL:**

Changes in goodwill during the year:

	<b>Year ended December 31, 2004</b>				
	<b>In thousands</b>				
	<b>Delta USA</b>	<b>US Upper market</b>	<b>Europe</b>	<b>Socks</b>	<b>Total</b>
Goodwill at beginning of year	\$46,732	\$2,119	\$753	\$4,754	\$54,358
Changes during the year:					
Goodwill arising from acquisition of subsidiaries, see notes 2a and 2b	3,873		1,057		4,930
Adjustment to purchase price, see note 2c				(1,368)	(1,368)
Goodwill at end of year	<u>\$50,605</u>	<u>\$2,119</u>	<u>\$1,810</u>	<u>\$3,386</u>	<u>\$57,920</u>

  

	<b>Year ended December 31, 2003</b>				
	<b>In thousands</b>				
	<b>Delta USA</b>	<b>US Upper market</b>	<b>Europe</b>	<b>Socks</b>	<b>Total</b>
Goodwill at beginning of year	\$40,032	\$2,119	\$753	\$3,386	\$46,290
Changes during the year:					
Goodwill arising from Acquisition of operations, see note 2c				1,368	1,368
Adjustment to purchase price, see note 2f	6,700				6,700
Goodwill at end of year	<u>\$46,732</u>	<u>\$2,119</u>	<u>\$753</u>	<u>\$4,754</u>	<u>\$54,358</u>

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 – EMPLOYEE RIGHTS UPON RETIREMENT:**

- a. Employee related obligations are composed as follows:  
b.

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Accrued severance pay	\$6,076	\$5,442
Obligation in respect of defined benefit plans	1,332	1,290
	<u>\$7,408</u>	<u>\$6,732</u>

As of December 31, 2004 and 2003, the Group had deposits of \$ 5.7 million and \$ 5.1 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. 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, 2004, 2003 and 2002 were \$ 6.9 million, \$ 7.0 million and \$ 6.5 million respectively (in 2004, 2003 and 2002, excluding \$ 190 thousands, \$ 850 thousands and \$ 651 thousands, respectively, relating to the termination of employment, which were charged to restructuring expenses, see note 12e).

The profit (loss) from deposits in respect of severance pay were \$ 416 thousands, \$(214) thousands and \$(624) thousands in the years ended December 31, 2004, 2003 and 2002, 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.

**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:

- a) 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.
- b) 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.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 – EMPLOYEE RIGHTS UPON RETIREMENT** (continued):

- c) 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, 2004, the assets of the defined benefit pension plan are primarily invested in group annuity contracts with an insurance company. The plan was frozen effective January 1996.

Contributions to the defined contribution 401(k) plan 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.

**c. Certain details relating to defined benefit plans:**

	<u>2004</u>	<u>2003</u>	
	<u>In thousands</u>		
<b>Change in benefit obligation:</b>			
Benefit obligation at beginning of year	\$3,145	\$3,150	
Interest cost	179	183	
Actuarial loss	20	7	
Benefit paid	(204)	(195)	
Benefit obligation at end of year	<u>\$3,140</u>	<u>\$3,145</u>	
<b>Change in plan assets:</b>			
Fair value of plan assets at beginning of year	\$2,888	\$2,931	
Actual return on plan assets	90	152	
Employer contribution	225		
Benefit paid, including plan expenses	(204)	(195)	
Fair value of plan assets at end of year	<u>\$2,999</u>	<u>\$2,888</u>	
<b>Reconciliation of funded status:</b>			
Funded status (carryforward obligations)	\$(141)	\$(257)	
Unrecognized net actuarial loss	1,332	1,290	
Adjustment to recognize minimum liability	(1,332)	(1,290)	
Prepaid / pension cost (accrued)	<u>\$(141)</u>	<u>\$(257)</u>	
<b>Weighted average assumptions at end of year:</b>			
Discount rate	5.75%	6.00%	6.25%
Expected return on plan assets	6.25%	6.25%	6.50%
Rate of compensation increase	N/A	N/A	N/A

**DELTA GALIL INDUSTRIES LTD.**

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 7 – EMPLOYEE RIGHTS UPON RETIREMENT** (continued):

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

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Interest cost	\$179	\$183	\$ 190
Actual return on plan assets	(122)	(85)	(134)
Net amortization	10	13	57
	<u>\$67</u>	<u>\$111</u>	<u>\$113</u>

**d. Cash flows information regarding the company's liability for employee rights upon retirement:**

1. The Company expects to contribute in 2005, \$670 thousands to insurance companies and \$270 thousands to contribution plans.
2. The Company expects to pay the following future benefits to its Israeli employees upon their normal retirement age:

	<b>Severance pay benefits</b>
	<b>In thousands</b>
2005	\$52
2006	\$283
2007	\$61
2008	\$801
2009	\$159
Years 2010-2014	\$1,196

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 amounts that might be paid to employees that will cease working with the Company before their normal retirement age.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 – LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY:**

**a. Composition:**

	<b>Weighted average interest rate</b>	<b>December 31</b>	
	<b>December 31, 2004</b>	<b>2004</b>	<b>2003</b>
	<b>%</b>	<b>In thousands</b>	
Bank loans - in dollars or linked thereto	3.8%	\$126,131	\$18,857
Bank loans - in Canadian dollars			5,191
Bank loans - in other currencies	5.5%	216	
Other liability -			
Obligation under capital lease, see note 1f and c below - in dollars	8.6%	<u>1,032</u>	<u>1,097</u>
		127,379	25,145
L e s s - current maturities		<u>27,942</u>	<u>10,436</u>
		<u>\$99,437</u>	<u>\$14,709</u>

**b. Total liabilities (net of current maturities) mature in the following years after balance sheet dates:**

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Second year	\$29,703	\$10,440
Third year	23,270	1,018
Fourth year	23,230	1,024
Fifth year	22,584	1,031
Sixth year and thereafter	<u>650</u>	<u>1,196</u>
	<u>\$99,437</u>	<u>\$14,709</u>



**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 8 – LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY** (continue):

- c. A subsidiary of the Company has entered into capital lease agreements for a building it uses; the lease will expire in the year 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, 2004:

	<b><u>In thousands</u></b>
First year – current maturities	158
Second year	158
Third year	158
Fourth year	158
Fifth year	158
Sixth year and thereafter	<u>790</u>
	1,580
Less – amount representing interest	<u>548</u>
	<u><u>1,032</u></u>

- d. The balance of liabilities is fully secured by floating charges in an unlimited amount on all the assets and rights of the Company and the assets of its subsidiaries, and/or by fixed charges on the major portion of the Group's fixed assets.
- e. A subsidiary is a party to a credit agreement, which was amended, as of 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. The credit agreement provides for \$ 130 million in loans, of which \$ 70 million are long term loans which bear interest of Libor +1.4% and the remainder is short term credit which bear interest of Libor +1.15%. The principal of the term loans is payable in 20 equal quarterly installments of approximately \$3.5 million each until December 1, 2009. As of December 31, 2004 the unutilized credit line was \$ 15.2 million.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 9 – COMMITMENTS AND CONTINGENT LIABILITIES:

##### a. Commitments

The Company and its subsidiaries lease 30 facilities under operating leases. The leases (including extension options) for 18 facilities expire on various dates between 2006 and 2025 and the remaining leases expired in 2005. The Company intends to renew some of these leases. The minimum future annual lease payment over each of the years 2005 to 2009 will amount to \$7.6, \$6.6, \$6.5, \$6.0 and \$5.4 million, respectively. In the period from 2010 to the end of the lease periods, the cumulative lease payments will amount to \$ 11.2 million. The lease expenses for each of the years 2004, 2003 and 2002 were \$ 8.6 million, \$ 7.3 million and \$ 6.6 million, respectively.

##### b. Contingent liabilities - Guarantees

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

c. As to contingent consideration, see note 2a.

d. The Company entered into agreements that provide the Company rights to market products brand names owned by other parties. Royalties under these agreements are calculated as a percentage of the sales. The royalties rate range from 4% to 16% of sales.

#### NOTE 10 – 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, 2004, the closing price per ADS on Nasdaq was \$10.34; the shares were quoted on the TASE on that date at NIS 43.81 (\$10.09).
- 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) In December 2002, the Company purchased 565,000 of the Company's shares for an amount of \$ 6,215 thousands (representing \$ 11.0 per share).
- 4) On September 28, 2001, the Company's Board of Directors approved the repurchase of Company shares for an amount of up to \$3.0 million. During 2002 and 2001 the Company purchased 282,483 and 96,017 shares, respectively, in the open market at an average price of \$7.58 and \$9.0 per share in a total amount of \$2,141 thousands and \$860 thousands, respectively.
- 5) As of December 31, 2004 and 2003, 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, is 45,884 and 87,638 shares, respectively.
- 6) The shares held by the Company have no voting rights and are not entitled to receive dividends.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 – SHAREHOLDERS' EQUITY (continued):**

**b. Stock options plans for employees and the Company's CEO:**

- 1) On May 10, 1998, the Company's Board of Directors approved an employee stock option plan for the grant, without consideration, of up to 304,696 options, exercisable in purchase of 319,931 ordinary shares of NIS 1 par value of the Company, to thirteen senior employees of the Company and/or its subsidiaries. All of the above options were granted in June 1998. The exercise price of each option is \$ 8.297, based on the quoted price of the Company's shares on the last day of trade prior to the Board of Directors' resolution (\$ 9.22), less 10%. The options vest in four equal batches.

As of December 31, 2004, all the options are fully vested. The options are exercisable over three years period, commencing on the date that is two years after the date such option vested. Any option not exercised within the said five years will expire. The options expire over the years 2003-2006.

- 2) On September 10, 1998, the Company's Board of Directors approved a plan for the grant, at no consideration, of up to 100,000 options to its CEO, which are exercisable in purchase of 100,000 shares of NIS 1 par value of the Company. All of said options were granted in September 1998. The exercise price of each option is \$ 7.90, based on the quoted price of the Company's share on the last day of trade prior to the Board of Directors' resolution (\$ 8.77), less 10%. The options vest in four equal batches. As of December 31, 2004, all the options are fully vested. The exercise terms under the CEO's plan are identical to those of the employees plan.
- 3) On June 4, 2000, the Company's Board of Directors approved an employee stock option plan for the grant, without consideration, of up to 809,000 options (including 100,000 options to its CEO), exercisable to 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 vest in four equal batches: the first, second, third and fourth batch vest in August 2001, 2002, 2003 and 2004, respectively. The options are exercisable over a three years period, commencing one year after the vesting date of each batch.

- 4) On October 23, 2002, the Company's Board of Directors approved an employee stock option plan for the grant, without consideration, of up to 1,100,000 options (including 100,000 options to its 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 to 97 senior employees of the Group (including 100,000 options to the CEO) at an exercise price of \$ 9. The options vest in four equal batches. The first, second, third and fourth batches will vest in November 2003, 2004, 2005 and 2006, 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.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 – SHAREHOLDERS' EQUITY** (continued):

In May 2003 the Company granted 30,000 options to three employees of the Group at an exercise price of \$10.76. 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 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, 2004 72,000 options remain available for grant under the plan.

- 5) The grant of options 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.
- 6) 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.
- 7) Following is a summary of the status of the Company's stock option plans:

	Year ended December 31					
	2004		2003		2002	
	Number*	Weighted average exercise price**	Number*	Weighted average exercise price**	Number*	Weighted average exercise price**
Options outstanding at beginning of year	1,830,702	\$13.50	2,038,562	\$ 13.07	1,076,940	\$ 17.10
Changes during the year:						
Granted – at market price	110,000	\$14.65	30,000	\$ 10.76	1,004,500	\$ 9.00
Exercised	(41,756)	\$7.91	(180,109)	\$ 7.91	(2,003)	\$ 7.91
Forfeited	(66,875)	\$9.34	(57,751)	\$ 11.35	(40,875)	\$ 18.11
Options outstanding at end of year	<u>1,832,071</u>	\$13.84	<u>1,830,702</u>	\$ 13.50	<u>2,038,562</u>	\$ 13.07
Options exercisable at end of year	<u>1,106,821</u>	\$14.69	<u>528,952</u>	\$ 17.15	<u>405,880</u>	\$ 16.94

\* Represents the number of shares arising upon exercise of options, based on the conversion ratio.

\*\* Per option.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 10 – SHAREHOLDERS' EQUITY (continued):**

- 8) The following table summarizes information regarding options outstanding at December 31, 2004:

<b>Number of shares issuable upon exercise of options</b>				
	<b>Outstanding</b>		<b>Vested</b>	<b>Exercisable</b>
<b>Exercise prices</b>	<b>Balance at December 31, 2004</b>	<b>Weighted average remaining contractual life</b>	<b>Balance at December 31, 2004</b>	<b>Balance at December 31, 2004</b>
		<b>Years</b>		
\$8.30	65,696	1.2	65,696	65,696
\$7.90	50,000	1.4	50,000	50,000
\$21.07	688,375	2.0	688,375	532,125
\$9.00	888,000	4.4	459,000	459,000
\$10.76	30,000	4.8	7,500	
\$15.35	80,000	5.8		
\$12.74	30,000	6.1		
	<u>1,832,071</u>		<u>1,270,571</u>	<u>1,106,821</u>

**c. Retained Earnings**

In determining the amount of retained earnings available for distribution as a dividend, the Companies Law stipulates that the cost of the Company's shares acquired by 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.

**NOTE 11 – TAXES ON INCOME:**

**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. 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.

## **DELTA GALIL INDUSTRIES LTD..**

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### **NOTE 11 – TAXES ON INCOME (continued):**

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.

Under the law, by virtue of the “approved enterprise” status granted to certain of their enterprises, the Company and its Israeli subsidiary are entitled to various tax benefits, as follows:

a) Reduced tax rates

During the period of benefits - 7 to 10 years commencing in the first year in which the companies earn taxable income from the approved enterprises (provided the maximum period to which it is restricted by law has not elapsed) – a reduced tax rate of 25% applies, instead of the regular tax rate, see (4) below. Some of the approved enterprises are eligible for a tax exemption for the first two years commencing in the year in which the companies first earn taxable income.

The proportion of the Company’s taxable income entitled to benefits of reduced tax rates is calculated on the basis of the ratio between the turnover of the approved enterprise and the whole turnover of the Company. The turnover applicable to the approved enterprise is calculated, as a general rule, by taking the increase resulting from the comparison of the Company’s turnover with its “base” turnover, which is prescribed as being the turnover during the last year before the operation of the approved enterprise, or such other basis as is stipulated in the instrument of approval.

The period of benefits in respect of certain enterprises expired in 1994, while the period of benefits in respect of other enterprises expires in 2006. The Company first derived income from approved enterprises in 1998.

In the event of distribution of cash dividends out of income, which was tax exempt as above, the companies would have to pay the 25% tax in respect of the amount distributed.

b) Accelerated depreciation

The companies are entitled to claim accelerated depreciation in respect of buildings, machinery and equipment used by approved enterprises during the first five tax years of the operation of these assets.

c) Conditions for entitlement to the benefits

The entitlement to the above benefits is conditional upon the companies fulfilling the conditions stipulated by the law, regulations published thereunder and the

instruments of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be cancelled and the companies may be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences to the Israeli CPI and interest.

## DELTA GALIL INDUSTRIES LTD.

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 11 – TAXES ON INCOME (continued):

- 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. Commencing 2001 the Company and two of its subsidiaries chose to do so.

As explained in note 1a(4), the financial statements were measured in dollars. For the years in which the result for tax purposes are measured in real terms, having regard to the changes in the Israeli CPI, the difference between the changes in the Israeli CPI and the exchange rate of the dollar - both on an annual and a cumulative basis - caused differences between taxable income and income reflected in these financial statements. 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.

- 3) Tax rates
- a) The income of the company and its Israeli subsidiaries (other than income from “approved enterprises”, see 1a. above) is taxed at the regular rate. Through to December 31, 2004, the corporate tax was 36%. In July 2004, an amendment to the Income Tax Ordinance was enacted. One of the provisions of this amendment is that the corporate tax rate is to be gradually reduced from 36% to 30%, in the following manner: the rate for 2004 is 35%, and will be in 2005 – 34%, in 2006 – 32%, and in 2007 and thereafter – 30%. The effect of the change in the tax rates in the coming years, on the deferred tax balances of the amendment to the law, is included under the item “taxes on income” in the statements of income.
- b) Pursuant to another amendment to the Income Tax Ordinance, which became effective in 2003, capital gains are taxed at a reduced rate of 25% from January 1, 2003, instead of the regular corporate tax rate at which such gains were taxed until the aforementioned date. The aforesaid amendment stipulates that with regard to the sale of assets acquired prior to January 1, 2003, the reduced tax rate will be applicable only for the gain allocated to capital gains earned after the implementation of the amendment, which will be calculated, as prescribed by said amendment.



**DELTA GALIL INDUSTRIES LTD..**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 11 – 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%

**c. Carryforward tax losses**

Carryforward tax losses (derived from the Israeli companies) as of December 31, 2004 and 2003, aggregate \$ 36 million and \$ 33 million, respectively.

Carryforward tax losses in Israel may be utilized indefinitely.

**d. Deferred income taxes:**

1) The deferred income taxes are composed as follows:

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Property, plant and equipment	\$13,832	\$13,975
Inventories	(841)	(907)
Provisions for employee related obligations	(1,457)	(1,551)
Other	653	(639)
In respect of carryforward tax losses (see c. above)	(10,968)	(10,042)
<b>Total</b>	<b>\$1,219</b>	<b>\$836</b>

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

**NOTE 11 – TAXES ON INCOME** (continued):

2) Deferred income taxes are presented in the balance sheets among:

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Current asset	\$(3,675)	\$(5,464)
Long term liability	4,894	6,300
	<u>\$1,219</u>	<u>\$836</u>

e. **Income before income taxes is composed as follows:**

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
The Company and its Israeli Subsidiaries	\$3,190	\$(4,832)	\$(8,658)
Non-Israeli subsidiaries	13,946	36,263	31,930
	<u>\$17,136</u>	<u>\$31,431</u>	<u>\$23,272</u>

f. **Taxes on income included in the statements of income:**

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Current:			
Israeli	\$1,636	\$746	\$353
Non-Israeli	1,941	10,292	4,963
	3,577	11,038	5,316
Deferred:			
Israeli	\$(498)	\$(4,075)	\$(1,796)
Non-Israeli	219	520	2,236
	(279)	(3,555)	440
For previous years :			
Israeli	\$(516)	\$(30)	\$(112)
Non-Israeli	64	(113)	135
	(452)	(143)	23
	<u>\$2,846</u>	<u>\$7,340</u>	<u>\$5,779</u>

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 11 – TAXES ON INCOME** (continued):

- g. Following is a reconciliation of the theoretical tax expense, assuming all income is taxed at the regular tax rates applicable to income of companies in Israel (36% in the years 2002 and 2003, and 35% in 2004) and the actual tax expense:

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Income before taxes on income, as reported in the consolidated statements of income	\$17,136	\$31,431	\$23,272
Theoretical tax expense	\$5,997	\$11,315	\$8,378
Additional tax expenses arising from reduced tax rate on losses from an approved enterprise	73	380	958
Decrease in tax arising from different tax rate applicable to non-Israeli subsidiaries	(2,575)	(2,834)	(3,886)
	3,495	8,861	5,450
Increase (decrease) in taxes resulting from permanent differences:			
Disallowable deductions	110	36	22
Previous years	(452)	(143)	23
Difference between the basis of measurement of income reported for tax purposes and the basis of measurement of income for financial reporting purposes - net	(807)	151	(242)
Sundry – net	500	(1,565)	526
Taxes on income – in the consolidated statements of income	\$2,846	\$7,340	\$5,779

**h. Tax assessments**

Tax assessments for the Company and most of its subsidiaries are final through the tax year 1999.

**DELTA GALIL INDUSTRIES LTD.**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:**

**Balance sheets:**

	December 31		
	2004	2003	2002
	In thousands		
<b>a. Accounts receivable:</b>			
1) Trade:			
Outside Israel	\$90,682	\$73,883	
In Israel	14,447	11,840	
	<u>\$105,129</u>	<u>\$85,723</u>	
Allowance for doubtful accounts:			
Opening balance	\$1,038	\$1,131	\$3,671
Hamashbir			859
Other			95
Decrease due to bad debts			
Hamashbir	(872)		
K-Mart			(3,494)
Other	(39)	(123)	
Increase due to an acquisition of a new subsidiary		30	
Closing balance	<u>\$127</u>	<u>\$1,038</u>	<u>\$1,131</u>
Principal customers (see note 1m and 15c):			
Customer 1	<u>\$2,656</u>	<u>\$18,890</u>	
Customer 2	<u>\$29,871</u>	<u>\$15,907</u>	
Customer 3	<u>\$15,455</u>	<u>\$16,500</u>	
2) Other:			
Investment grant receivable	\$646	\$576	
Government departments – mainly value added tax refundable	1,501	4,500	
Prepaid expenses	1,822	2,046	
Deposits	858	663	
Income receivable	1,184	96	
Employees	380	512	
Receivables from subcontractors	2,987	1,157	
Sundry	1,249	1,112	
	<u>\$10,627</u>	<u>\$10,662</u>	

**DELTA GALIL INDUSTRIES LTD.**

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
<b>b. Inventories:</b>		
Finished products	\$137,813	\$94,338
Products in process	21,829	21,380
Raw materials and supplies	12,797	19,918
Packaging and maintenance materials	11,328	7,348
	<u>\$183,767</u>	<u>\$142,984</u>

**c. Short-term bank credit**

The weighted average interest rate of short-term bank credit as of December 31, 2004 and 2003 is 3.5% and 1.9% , respectively.

A subsidiary is a party to a credit agreement, which was amended, as of 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. The credit agreement provides for up to \$ 60 million in short term credit (see note 8e).

Unutilized short-term credit lines of the Group (under the USA credit agreement and other credit agreements) as of December 31, 2004 and 2003 aggregated to \$ 163 million and \$ 100 million, respectively.

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
<b>d. Accounts payable and accruals - other:</b>		
Employees and employee institutions	\$7,745	\$7,589
Provision for vacation and recreation pay	4,297	4,463
Income tax payable	2,731	1,612
Accrued expenses	18,300	17,956
Accrued expenses – restructuring costs		6,163
In respect of purchase price adjustment, see note 2f		6,700
In respect of derivatives, see note 13c		2,657
Other	1,010	1,002
	<u>\$34,083</u>	<u>\$48,142</u>

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):

**Statements of income:**

**e. Restructuring expenses**

- 1) Consolidated statements of operations for the years ended December 31, 2004, 2003 and 2002 include restructuring costs in the Europe segment totaling approximately \$1.1 million \$1.0 million and \$1.1 million respectively. During the years ended December 31, 2004, 2003 and 2002, the Company implemented restructuring plans which included the dismissal of a total of approximately 1,300 employees and the closing of certain of the company's sewing plants and logistic centers.
- 2) The primary components of the restructuring costs are:

	Year ended December 31		
	2004	2003	2002
	In thousands		
Costs relating to workforce reduction	\$190	\$850	\$651
Costs relating to write-off of fixed assets	50	157	414
Costs relating to write-off of other accounts receivable	860		
	<u>\$1,100</u>	<u>\$1,007</u>	<u>\$1,065</u>

**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 by May 2005.

**The 2003 program**

During 2003, the Company initiated a restructuring program designed to reduce its cost structure (the "2003 program"). The 2003 Program included the closure of sewing plants in Scotland and in Israel. The 2003 Program resulted in total restructuring charges to the Company of \$1.0 million, which were recorded in the first quarter of 2003.

The implementation of the 2003 Program in Scotland, which represented \$0.9 million of the total charges of \$1.0 million, consisted of the dismissal of approximately 100 persons who had previously been employed by the Company's European subsidiary.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):

The implementation of the 2003 Program in Israel which represented \$0.1 million of the total charges of \$1.0 million, consisted of the dismissal of approximately 70 employees in Israel, who had previously been employed by the Company's. 2003 Program was concluded by the end of the first quarter of 2003.

**The 2002 program**

During 2002, the company initiated restructuring program designed to reduce its cost structure (the "2002 program"). The 2002 program included the closure of cutting and sewing facilities in Scotland and in the Dominican Republic. The 2002 program resulted in total restructuring charges to the Company of \$1.1 million which were recorded in the fourth quarter of 2002.

The implementation of the 2002 program in Scotland, which represented \$0.7 million of the total \$1.1 million, consisted of the dismissal of approximately 100 employees in Scotland.

The implementation of the 2002 program in Dominican Republic, which represented \$0.4 million of the total \$1.1 million, consisted of the dismissal of approximately 800 employees in the Dominican Republic.

As to restructuring plan with respect to an acquired company, in 2003, see note 2c.

**f. Financial expenses – net:**

	<b>Years ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Interest expenses	\$4,923	\$3,824	\$4,286
Interest income	(42)	(58)	(92)
Exchange differences and other – net	763	1,259	939
Losses from derivatives instruments	587	612	323
	<u>\$6,231</u>	<u>\$5,637</u>	<u>\$5,456</u>

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 12 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION** (continued):**g. Earnings per share**

Following is data relating to the weighted average number of shares used in the computation of diluted earnings per share:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	<u>In thousands</u>		
Weighted average number of shares used in the computation of basic earnings per share	18,478	18,313	18,914
Add:			
Net additional shares from the anticipated exercise of stock options	<u>356</u>	<u>450</u>	<u>13</u>
Weighted average number of shares used in the computation of diluted earnings per share	<u>18,834</u>	<u>18,763</u>	<u>18,927</u>

**NOTE 13 – 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 dollar. Derivative financial instruments (“derivatives”) are utilized by the Group to reduce these risks, as explained in this note. As the counter parties to these derivatives are Israeli banks, the Company considers the inherent credit risks remote. The Company does not hold or issue derivative financial instruments for trading purposes.

**b. Foreign exchange risk management**

The Company enters into most 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 and from salaries, wages and related expenses, will be affected by changes in exchange rates. The term of most of these contracts is less than one year.

These transactions are mainly for the exchange of pounds sterling, Euro and NIS into dollars.



**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 13 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT** (continued):

For forward exchange contracts designated as cash flow hedges, gains and losses are recorded in other comprehensive income (loss) until the foreign currency denominated sales, salaries, wages and related expenses transactions are recognized in earnings.

The following table summarizes changes in other comprehensive income (loss) related to derivatives that are classified as cash flow hedges held by the Company during the period from January 1, 2002 through December 31, 2004:

	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>\$ In thousands</b>		
Balance at beginning of year	\$(1,715)	\$(583)	\$225
Changes in effective portion of derivatives designated as cash flow hedges	691	(2,905)	(2,114)
Reclassification into earnings from other comprehensive income	1,822	1,299	943
Net of tax effect	(798)	474	363
Balance at end of year	<u>-;</u>	<u>\$(1,715)</u>	<u>\$(583)</u>

Hedge loss related to the portion of cash flow hedging instruments excluded from assessment of effectiveness had impact on earnings for 2004 of \$ 0.6 million, 2003 of \$ 0.7 million loss and had no material impact on earnings for the years ended December 31, 2002. No cash flow hedges were discontinued during the years ended December 31, 2004, 2003 and 2002.

As of December 31, 2004, the Company has no derivatives instruments outstanding.

**c. Fair value of financial instruments**

The financial instruments of the Group consist mainly of non-derivative assets and liabilities (items included in working capital, long-term receivables - in insignificant amounts - and long-term liabilities); the Group also has derivatives.

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, or are in immaterial amounts. The fair values derivatives as of December 31, 2003 was \$ 2,657 thousands (As of December 31, 2004, the Company has no derivative instruments).

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 14 – “RELATED PARTIES” – TRANSACTIONS AND BALANCES:**

**a. Transactions with related parties:**

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Net revenues	<u>\$1,303</u>	<u>\$2,433</u>	<u>\$4,922</u>
Purchases and other expenses	<u>\$21</u>	<u>\$249</u>	<u>\$410</u>

The above transactions were made with one of the 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 CEO, see note 10b.

**b. Related parties balances:**

	<b>December 31</b>	
	<b>2004</b>	<b>2003</b>
	<b>In thousands</b>	
Current receivables – presented in the balance sheets among “accounts receivable – trade”	<u>\$126</u>	<u>\$251</u>
Current liabilities – presented under “accounts payable and accruals”	<u>\$20</u>	<u>\$28</u>

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 15 – SEGMENT INFORMATION :**

**a. Information on operating segments:**

**Operating segments:**

1) General:

The Company conducts its worldwide operations in five operating segments as follows:

Delta USA, U.S upper market and Europe- these segments are engaged in manufacturing and marketing of intimate apparel to various customers in the U.S and European markets.

Socks- the segment is engaged in manufacturing and marketing of socks to various customers in the U.S and European markets.

Delta marketing Israel – this segment is engaged in marketing of intimate apparel to various customers in Israel through retail and wholesale operations.

The Company changed its internal organization by transferring Socks marketing operation in Israel to the managerial responsibility of Delta Marketing Israel. In addition, US upper market and the textile divisions were merged. Numbers included below have been reclassified accordingly.

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.

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 profits (losses) of associated companies and minority interest, since those items are not allocated to the segments.

Sale price of intersegment revenue is based on negotiation between the segments and when applicable upon market price.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 15 – SEGMENT INFORMATION** (continued):

b) Financial data relating to reportable operating segments:

	<u>Delta USA</u>	<u>US Upper market</u>	<u>Europe</u>	<u>Socks</u>	<u>Delta Marketing Israel</u>	<u>Adjustments</u>	<u>Total</u>
	(U.S. \$ In thousands)						
Year ended December 31, 2004:							
Net revenues:							
To unaffiliated customers	\$186,280	\$90,540	\$193,638	\$138,749	\$46,460	\$(1,398)(1)	\$654,269
Intersegment		\$21,312	\$165	\$5,435		\$(26,912)	-
Total net revenues	<u>\$186,280</u>	<u>\$111,852</u>	<u>\$193,803</u>	<u>\$144,184</u>	<u>\$46,460</u>	<u>\$(28,310)</u>	<u>\$654,269</u>
Operating income (loss)	<u>\$5,911</u>	<u>\$(568)</u>	<u>\$4,906(4)</u>	<u>\$9,137</u>	<u>\$4,753</u>	<u>\$(1,730)(2)</u>	<u>\$22,409</u>
Assets (at end of year)	<u>\$225,744</u>	<u>\$98,055</u>	<u>\$100,264</u>	<u>\$56,271</u>	<u>\$23,866</u>	<u>\$30,297(3)</u>	<u>\$534,497</u>
Depreciation and amortization	<u>\$1,438</u>	<u>\$6,097</u>	<u>\$4,326</u>	<u>\$2,463</u>	<u>\$450</u>	<u>\$411</u>	<u>\$15,185</u>

(1) Includes results of hedge transactions.

(2) Includes mainly the effect of hedge transactions in an amount of \$1,700 thousands.

(3) Includes general corporate assets not assignable to segments.

(4) Includes restructuring expenses in the amount of \$1,500 thousands relating to the closure of a logistic center in Hungary.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 15 – SEGMENT INFORMATION** (continued):

	<u>Delta USA</u>	<u>US Upper market</u>	<u>Europe</u>	<u>Socks</u>	<u>Delta Marketing Israel</u>	<u>Adjustments</u>	<u>Total</u>
	(U.S. \$ In thousands)						
Year ended December 31, 2003:							
Net revenues:							
To unaffiliated customers	\$213,241	\$66,665	\$176,827	\$86,393	\$37,561	\$(557) (1)	\$580,130
Intersegment		21,603	563	3,022		(25,188)	- ;-
Total net revenues	<u>\$213,241</u>	<u>\$88,268</u>	<u>\$177,390</u>	<u>\$89,415</u>	<u>\$37,561</u>	<u>\$(25,745)</u>	<u>\$580,130</u>
Operating income (loss)	<u>\$24,780</u>	<u>\$(8,871)</u>	<u>\$4,453 (4)</u>	<u>\$8,997</u>	<u>\$2,415</u>	<u>\$5,042 (2)</u>	<u>\$36,816</u>
Assets (at end of year)	<u>\$137,762</u>	<u>84,185</u>	<u>\$109,377</u>	<u>\$69,877</u>	<u>\$19,774</u>	<u>\$29,909 (3)</u>	<u>\$450,884</u>
Depreciation and amortization	<u>\$1,561</u>	<u>\$5,560</u>	<u>\$4,368</u>	<u>\$2,148</u>	<u>\$398</u>	<u>\$495</u>	<u>\$14,530</u>

(1) Includes results of hedge transactions.

(2) Including mainly capital gain in an amount of \$ 4,050 thousands, the effect of losses of hedge transactions in an amount of \$ 1,300 thousands and gain of \$600 thousands which represents the minority share in the operating profits of certain subsidiary - included in the US Upper market - which is partly consolidated for segment purposes and fully consolidated in the consolidated financial statements.

(3) Includes general corporate assets not assignable to segments.

(4) Includes restructuring expenses in the amount of \$ 1,007 thousands relating to the closure of sewing facilities in Scotland and in Israel.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 15 – SEGMENT INFORMATION** (continued):

	<u>Delta USA</u>	<u>US Upper market</u>	<u>Europe</u>	<u>Socks</u>	<u>Delta Marketing Israel</u>	<u>Adjustments</u>	<u>Total</u>
	<b>(U.S. \$ In thousands)</b>						
Year ended December 31, 2002:							
Net revenues:							
To unaffiliated customers	\$202,024	\$81,968	\$170,265	\$79,193	\$34,808	\$(960) (1)	\$567,298
Intersegment		29,157	706	4,710		(34,573)	- ;-
Total net revenues	<u>\$202,024</u>	<u>\$111,125</u>	<u>\$170,971</u>	<u>\$83,903</u>	<u>\$34,808</u>	<u>\$(35,533)</u>	<u>\$567,298</u>
Operating income (loss) (3)	<u>\$14,575</u>	<u>\$(4,731)</u>	<u>\$10,205</u>	<u>\$8,319</u>	<u>\$(1,267)</u>	<u>\$667 (4)</u>	<u>\$27,768</u>
Assets (at end of year)	<u>\$143,730</u>	<u>\$94,849</u>	<u>\$105,522</u>	<u>\$46,413</u>	<u>\$17,129</u>	<u>\$33,415 (2)</u>	<u>\$441,058</u>
Depreciation and amortization	<u>\$1,294</u>	<u>\$5,518</u>	<u>\$3,932</u>	<u>\$2,420</u>	<u>\$387</u>	<u>\$531</u>	<u>\$14,082</u>

(1) Includes results of hedge transactions.

(2) Includes general corporate assets not assignable to segments.

(3) Includes restructuring costs in the amount of \$ 673 thousands in Europe and \$ 392 thousands in Delta USA.

(4) Including mainly the losses of hedge transactions in an amount of \$ 960 thousands and gains of \$ 1,025 thousands which represents the minority share in the operating profits of certain subsidiary – included in the US Upper market – which is partly consolidated for segment purposes and fully consolidated in the consolidated financial statements.

**DELTA GALIL INDUSTRIES LTD.**

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**NOTE 15 – SEGMENT INFORMATION** (continued):

**b. Geographical information:**

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
1) Revenues			
attributed to geographic area			
(based on the location of the			
customers):			
North America	\$334,833	\$300,708	\$303,103
United Kingdom	202,831	187,885	181,302
Europe (other than U.K.)	64,605	48,766	44,409
Israel	52,000	42,771	38,484
	<u>\$654,269</u>	<u>\$580,130</u>	<u>\$567,298</u>

2) The net balance of the Company's property, plant and equipment, by geographic location, are as follows:

	<b>December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Israel	\$57,685	\$60,108	\$64,998
Egypt	24,464	22,218	20,940
United States	15,637	8,369	7,284
Eastern Europe	11,370	11,719	6,803
Jordan	9,470	9,666	10,510
United Kingdom	3,831	4,429	7,740
Ireland	1,184	5,450	
Thailand	2,108		
Other	2,592	2,918	3,326
	<u>\$128,341</u>	<u>\$124,877</u>	<u>\$121,601</u>

**c. Revenues from principal customers:**

	<b>Year ended December 31</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>In thousands</b>		
Customer 1	<u>\$188,947</u>	<u>\$179,120</u>	<u>\$174,195</u>
Customer 2	<u>\$86,177</u>	<u>\$82,472</u>	<u>\$76,910</u>
Customer 3	<u>\$70,157</u>	<u>\$86,829</u>	<u>\$ 65,317</u>

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DELTA TEXTILES  
(LONDON) LIMITED

We have audited the balance sheets of Delta Textiles (London) Limited ("the Company") as at 31 December 2004 and 31 December 2003 and the related statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended 31 December 2004. 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 generally accepted auditing standards in the United Kingdom and 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 the significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall annual accounts presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2004 and 31 December 2003 and the results of its operations, changes in its shareholders' equity and cash flows for each of the three years in the period ended 31 December 2004, in conformity with generally accepted accounting principles in the United Kingdom. In addition they present fairly, in all material respects, the financial position of the Company as at 31 December 2003 and 31 December 2003 and the results of its operations for each of the three years in the period ended 31 December 2004 and the generally accepted accounting principles in the United States of America.

BAKER TILLY

Registered Auditor  
Chartered Accountants  
2 Bloomsbury Street  
London WC1B 3ST  
United Kingdom

15 June 2005



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To the shareholders of  
DELTA TEXTILE EGYPT (S.A.E.)

We have audited the balance sheets of DELTA TEXTILE EGYPT (S.A.E.) as of 31 December 2004 and 2003 and the related statements of income, changes in shareholder's equity and cash flows for each of the three years in the period ended 31 December 2004. 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 auditing standards generally accepted in the United States of America. 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 annual accounts presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2004 and 2003, and the results of its operations, changes in its shareholders' equity and its cash flows for each of the three years in the period ended 31 December 2004, in conformity with generally accepted accounting principles ("GAAP") in the United States.

EMAD H. RAGHEB  
FFSAA - FEST  
(RAA - 3678)

CAIRO 15 June 2005

<PAGE>

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To the shareholders of  
DELTA SOURCING EGYPT (L.L.C)

We have audited the balance sheets of DELTA SOURCING EGYPT (L.L.C) as of 31 December 2004 and 2003 and the related statements of income, changes in shareholder's equity and cash flows for each of the three years in the period ended 31 December 2004. 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 auditing standards generally accepted in the United States of America. 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 annual accounts presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2004 and 2003, and the results of its operations, changes in its shareholders' equity and its cash flows for each of the three years in the period ended 31 December 2004, in conformity with generally accepted accounting principles ("GAAP") in the United States.

EMAD H. RAGHEB  
FFSAA - FEST  
(RAA - 3678)

CAIRO 15 June 2005