

תל אביב, 23 ביוני 2004

לכבוד
הבורסה לניירות ערך
תל-אביב

לכבוד
הרשות לניירות ערך
ירושלים

א.ג.נ,

מצ"ב עותק של Form 20-F כפי שהוגש ביום ה' ה- 23 ביוני 2004 בארה"ב.

170 עותקים לבורסה לניירות ערך יומצאו בהקדם, עם קבלתם מבית הדפוס בארה"ב.

בכבוד רב,

מיקי לקסר, חשב
דלתא גליל תעשיות בע"מ
ח.צ. 520025602

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, 2003

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, 2003 the Registrant had 19,947,849 ordinary shares outstanding (including 1,422,486 ordinary shares owned by the Registrant and 87,638 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 X No

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

Item 17 Item 18 X

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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 5A. Operating and Financial Review and Prospects — Operating Results”.

Delta Galil had 19,947,849 ordinary shares outstanding as of June 15, 2004. Percentages of outstanding shares used herein are based on 18,458,864 ordinary shares outstanding as of June 15, 2004, which excludes 1,422,486 ordinary shares held by Delta Galil, and 66,499 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,				
	1999	2000	2001	2002	2003
	(\$ in thousands, except per share data)				
Statement of Income Data:					
Net revenues	\$355,237	\$434,404	\$558,763	\$567,298	\$580,130
Cost of revenues.....	272,441	341,458	455,726	456,738	466,378
Gross profit	82,796	92,946	103,037	110,560	113,752
Selling, marketing, general administrative expenses, goodwill amortization and restructuring expenses.....	48,522	59,481	80,277	82,700	80,581
Gain (loss) on sale of assets and subsidiary shares	(761)	(117)	(553)	(92)	3,645
Operating income.....	33,513	33,348	22,207	27,768	36,816
Financial expenses – net	2,007	6,608	4,751	5,456	5,637
Other income - net	2,432	975	463	960	252
Income before taxes on income	33,938	27,715	17,919	23,272	31,431
Taxes on income	9,836	5,511	5,876	5,779	7,340
Income after taxes on income ...	24,102	22,204	12,043	17,493	24,091
Share in profits (losses) of associated companies – net	480	340	110	158	(300)
Minority interests – net	(968)	(563)	(729)	(1,025)	(439)
Net income.....	<u>\$ 23,614</u>	<u>\$21,981</u>	<u>\$11,424</u>	<u>\$16,626</u>	<u>\$23,352</u>
EPS					
Basic	<u>\$1.46</u>	<u>\$1.23</u>	<u>\$0.60</u>	<u>\$0.88</u>	<u>\$1.28</u>
Diluted	<u>\$1.45</u>	<u>\$1.22</u>	<u>\$0.60</u>	<u>\$0.88</u>	<u>\$1.24</u>
Weighted average number of shares used in computation(1).....					
Basic.....	16,174	17,771	19,175	18,914	18,313
Diluted.....	16,286	17,996	19,199	18,927	18,763
Cash dividend per ordinary shares (2).....	\$0.42	\$0.37	\$0.30	\$0.37	\$0.52

(1) See note 13i 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, 2001, 2002 and 2003.

(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,				
	1999	2000	2001	2002	2003
	(\$ in thousands)				

Balance Sheet Data:

Cash and cash equivalents	\$ 4,977	\$ 8,633	\$ 12,762	\$14,491	\$17,699
Working capital	52,930	68,079	74,020	67,945	56,612
Total assets	265,030	371,044	424,965	441,058	450,884
Shareholders' equity	142,078	185,447	198,189	197,829	212,334
Amount of Share Capital	21,343	21,679	21,792	21,792	21,830

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.

Most of Delta Galil’s sales are to a few significant customers. Any reduction of purchases by Marks & Spencer or another significant customer could materially adversely affect Delta Galil’s revenues.

A majority of Delta Galil’s revenues is from sales to three customers. In 2003, 30.9% of Delta Galil’s revenues were from sales to Marks & Spencer, Delta Galil’s largest customer. Sales to Target reached 15.0% of

revenues and sales to Wal-Mart reached 14.2% of revenues. Delta Galil's contracts with its customers, including Marks & Spencer, 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 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 2003, Delta Galil produced goods in Jordan, Egypt, Turkey, Honduras, Eastern Europe and the Far East that accounted for approximately 81% 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 35% of our 2003 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 2003, Delta Galil derived 32% of its revenues from customers in pound sterling, 7% of its revenues were in NIS, and 8% were in euros. More than 10% of Delta Galil's expenses were in NIS in 2003.

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. As of December 31, 2003 Delta Galil had forward contracts for pound sterling only until June 2004. See Item 11: "Quantitative and Qualitative Disclosure – About Market Risk".

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 25.2% of the ordinary shares outstanding. Sara Lee beneficially owns 4,256,537 ordinary shares, representing 23.1% 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 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 0.4% of Delta Galil's 2003 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.

Integration of recent acquisitions with Delta Galil requires substantial managerial resources, and Delta Galil may be unable to achieve integration successfully.

In November 2003 Delta Galil completed the acquisition of Auburn Hosiery Mills and its subsidiaries. In 2000, Delta Galil completed the acquisition of Wundies Industries and, in 2001, of Inner Secrets, which were merged into one company named Delta Galil USA Inc. 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.

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® 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. Since October 2000, there has been an increase in hostilities between Israel and the Palestinians, and relations between Israel and its neighboring countries have consequently also deteriorated. 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 \$1.2 million in 2001, \$1.6 million in 2002 and \$1.1 million in 2003 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.

In 1999, Delta Galil used tax benefits estimated at approximately \$1.6 million. Because of 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. 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 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 or a removal of current quotas or a reduction in current tariffs applicable to exports from the Far East 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. 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. Delta Galil also benefits from tariffs and quotas applicable to goods produced in the Far East, which are not applicable to Delta

Galil's products produced outside the Far East. If there is a change in or termination of such benefits or if other countries enter into similar trade agreements, Delta Galil's trade advantage would be eroded and its business may be adversely affected.

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.)
- Gap (U.S.)
- Wal-Mart (U.S.)
- Hema (Holland)
- Kmart (U.S.)
- Target (U.S.)
- JC Penney (U.S.)
- Mervyn's (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, Israel and Scotland. Delta Galil traditionally manufactured in Israel and in Scotland. In recent years Delta Galil has been manufacturing in Jordan, Egypt and Turkey, and since 1999 in Romania and Bulgaria, shifting an increasing amount of labor intensive functions to these countries. In January 2000, Delta Galil acquired all of the assets of Dominion Hosiery Mills Inc., including its manufacturing facilities in Toronto, Canada. With the acquisitions of Wundies Industries Inc. in September 2000 and Inner Secrets in January 2001, Delta Galil also has a manufacturing plant in Honduras. In November 2002, Delta Galil purchased a logistic center in Hungary. During the year 2003, Delta Galil closed its manufacturing activities in Scotland and completed the acquisition of Auburn Hosiery Mills including its manufacturing facilities in the United States and in Ireland.

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.
- *Emphasize products that it can sell at a greater profit margin.* Delta Galil is shifting its focus to products that it can sell at a higher profit margin. Delta Galil introduced higher margin intimate apparel products, including, bras, nightwear and seam-free and support underwear, and it is continuing to innovate and develop higher margin products, such as products using microfibers.
- *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 Warner (U.S.), Puma, Polo, and Levi’s (Europe)
- *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 2002, Delta Galil purchased a logistics center in Hungary and in 2003 acquired Auburn Hosiery Mills, as more fully described below. Delta Galil may pursue additional strategic acquisitions of businesses that would complement its product lines and customer relationships.

Recent Acquisitions

Acquisition of Auburn

In November 2003, the Company 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 manufactures and 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.

Delta paid \$10.8 million in cash to Kellwood and recorded liabilities in respect of restructuring costs in the amount of \$6.2 million. Thus the total acquisition cost amounted to approximately \$17.0 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, 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 payments of \$6.7 million during April 2004. This payment has been 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 2001, 2002 and 2003.

<u>Product Category</u>	<u>Key Products</u>	<u>Key Customers/Brands</u>	<u>% of Revenues</u> <u>Year ended December 31,</u>		
			<u>2001</u>	<u>2002</u>	<u>2003</u>
Ladies' Intimate Apparel	Fashion and basic panties and bras (including seam-free) Women's nightwear Girl's nightwear	Marks & Spencer Wal-Mart Target JC Penney Victoria's Secret	58%	59%	61%
Socks	Men's, women's and children's leisure, dress and sport socks	Marks & Spencer Nike Wal-Mart Hema Sears Dim JC Penney	13%	15%	16%
Men's Underwear	Briefs Boxer shorts Mini-briefs Undershirts Men's nightwear	Calvin Klein Gap Hema Hugo Boss Marks & Spencer Polo Ralph Lauren	15%	11%	10%
Babywear	Fashion and classic items, focusing on newborns	Marks & Spencer	6%	7%	7%
Leisurewear	T-shirts Polo shirts Sweatshirts Leisure clothes	Marks & Spencer	3%	4%	3%
Others	Fabrics, Elastic tapes and other operations		5%	4%	3%

- *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.
- *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.
- *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.
- *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 \$310.6 million (which represented 56% of sales) in 2001. Our four target largest customers in North America, Wal-Mart, Target, Victoria's Secret and JCPenney, represented approximately 77% of our 2003 sales in North America. Although 2002 and 2003 sales to North America decreased by 2.4% and 0.8% to \$303.1 million and to \$300.1 million respectively (representing 52% of sales in 2003), we are expecting a strong rebound of sales to this market in 2004 mainly due to the acquisition of Auburn, which was consolidated only beginning in November 2003. For an explanation of the decrease, see Item 5: "Operating and Financial Review and Prospects – Results of Operations".

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 20 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 \$188 million in 2000, representing 43.4% of Delta Galil's revenues in 2000. The growth in Delta Galil's revenues from 1997 through 2000 was due largely to the increase in sales to Marks & Spencer. In 2000 and 2001, Marks & Spencer suffered from reduced sales and profitability. Delta Galil, as a leading supplier to Marks & Spencer, was affected by Marks & Spencer's decreased revenues as well as by the weakness of the pound sterling. In 2001 sales to Marks & Spencer, in dollar terms, amounted to \$153 million, a decrease of 19% compared to 2000, reflecting a sharp decrease in selling prices. In 2002 sales increased by 14% in dollar terms, compared to sales in 2001 and amounted to \$174 million. In 2003, sales were positively affected by the strengthening of the pound sterling which led to an increase of 3% in dollar terms, reaching \$179 million, compared to 2002.

Israeli Market

Delta Galil believes that it is among the market leaders in Israel for men's underwear, ladies' intimate apparel and socks, with \$38 million of sales in 2003. 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, 45% were made through retail department stores and supermarkets, 54% were made through Delta Galil's Delta Plus factory outlets and 1% were made through Delta Galil's new chain stores located in malls. As of December 31, 2003 Delta Plus had 79 stores, of which Delta Galil owned 43 directly and 36 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® and cotton-viscose) and elastics. 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 60 to 100 different types of fabric. Delta Galil operates approximately 140 automatic knitting machines, with a total production capacity of approximately 520-550 tons of fabric per month depending on the type of fabric produced. During 2003, Delta Galil produced approximately 380 tons of fabric per month, approximately 95% 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 1,800 knitting machines for the production of socks, including machines owned by sub-contractors, with a total production capacity of approximately 6.5 million pairs per month, which was fully utilized in 2003. Following the purchase of Auburn in November 2003, Delta Galil increased its total socks production capacity by approximately 6.0 million pairs per month.

- *Dyeing and Finishing:* Delta Galil has its own dyeing plants in Nahariya and Carmiel, Israel, in North America and in Ireland for dyeing of yarn, 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 15 million units per month (depending on the type of product). Delta Galil operates 9 sewing plants, of which one is located in Israel, three in Jordan, four in Egypt, one in Honduras and one in Hungary. 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. The design, development and manufacturing of these products require more resources than traditional products. Delta Galil has seen sales of seam-free products drop as it did not offer the market enough innovative products. Nevertheless, due to major improvement made in design and development of new products and increase in demand for seamless garments, Delta Galil foresees a rebound in this activity in 2004. As of December 31, 2003, Delta Galil owned 239 seam-free knitting machines acquired at an aggregate cost, net of grants, of approximately \$14 million and currently working at a yearly average capacity of approximately 70%. Following the increase in demand as described above, Delta Galil purchased another 30 seam-free machines during the first quarter of 2004.

Outsourcing of Products

Subcontractors manufactured goods in Egypt (babywear and underwear), Turkey (socks), Romania (bras, babywear and underwear), Bulgaria (socks) and Bangladesh, Mexico, El Salvador, Indonesia and China (all ladies intimate apparel), which in 2003 accounted for approximately 50% 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.

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 \$23.0 million in 2003, as compared to \$20.8 million in 2002, and \$19.5 million in 2001.

Delta Galil's Manufacturing Facilities

Delta Galil has manufacturing facilities in Israel, Jordan, Egypt, North America, Honduras, Hungary and Ireland. 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 and Jordan. Since 1996, seven sewing plants in northern Israel and all manufacturing plants in Scotland were closed and their production capacity was transferred to Egypt, Jordan and Eastern Europe, leaving Delta Galil with only one sewing plant in Israel. In 2003, 81% of Delta Galil's revenues were generated from the sale of products produced in low labor cost countries, up from 49% in 2000. In 2003, goods produced in Israel represented 14% 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</u>		
			<u>Year ended</u>		
			<u>December 31,</u>		
			<u>2001</u>	<u>2002</u>	<u>2003</u>
Far East	Purchase of finished products	Ladies intimate apparel	19%	22%	30%
	Sewing(1)				
Egypt	Knitting(2)	Ladies' intimate apparel	17%	19%	20%
	Dyeing(1)	Men's underwear			
	Cutting	Babywear			
	Sewing(2)	Leisurewear			
	Purchase of finished products				
Israel	Design	Ladies' intimate apparel	18%	14%	14%
	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	17%	15%	10%
	Cutting	Socks			
	Knitting (1)				
	Purchase of finished products				
Jordan	Sewing(2)(3)(5)	Ladies' intimate apparel	14%	13%	9%
		Men's underwear			
Turkey	Purchase of finished products	Socks	6%	7%	7%
Eastern Europe	Knitting(1)	Ladies' intimate apparel	3%	5%	6%
	Sewing(2)	Socks			
	Purchase of finished products	Babywear			
North America	Design	Ladies' intimate apparel	4%	4%	4%
	Cutting	Socks			
	Dyeing				
	Knitting(2)				
	Distribution center				
Scotland	Design	Babywear	2%	1%	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 \$6.2 million in 2003 and intends to spend \$7.1 million in 2004 to enhance its system's capabilities in order to support the growing demand for Delta Galil's products.

Political and Economic 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.

Economic Conditions

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. The Israeli government has, for these and other reasons, intervened in various sections of the economy, employing, among other means, fiscal and monetary policies, import duties, foreign currency restrictions and controls of wages, prices and foreign currency exchange rates. The Israeli government has periodically changed its policies in all these areas.

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 and Egypt, Delta Galil's products manufactured in Egypt can enter the EU countries duty free as well. Delta Galil also benefits from tariffs and quotas applicable to goods produced in the Far East, which are not applicable to Delta Galil's products produced outside the Far East. 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 24 subsidiaries in which it holds at least a 50% interest. Six of the subsidiaries are marketing subsidiaries in Europe, North America and Israel. The main operations are included in the following companies:

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

* 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, Ireland, Canada, Hungary and the United States. 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 2005 and 2013. The remaining lease expires in 2004, 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 owns a facility in Scotland, 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 2004 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, a logistic center in Hungary, 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 owned and leased properties and facilities as of June 15, 2004:

Plant location	Square feet	Main function
Carmiel, Israel	641,100	Textile manufacturing
Nahariya, Israel	257,000	Dyeing
Rosh Ha'ain, Israel	74,777	Offices and warehouse
Delta Plus retail chain, Israel	74,874	Retail
Yodaft, Israel	58,050	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
Scotland	103,000	Offices and warehouse
Ireland	128,000	Socks manufacturing, warehousing & offices
Jordan	240,000	Sewing and warehouse
Egypt	335,000	Knitting, cutting, sewing, warehouse and offices
New Jersey, U.S.	125,000	Logistic center, warehouse and offices
New York, U.S.	30,000	Offices
Pennsylvania, U.S.	400,000	Warehouse, logistic center and offices
Kentucky, US	205,000	Socks manufacturing, warehousing & offices
Honduras	108,000	Sewing and warehouse
Hong Kong	12,000	Offices and warehouse
Canada	38,700	Socks manufacturing

Plant location	Square feet	Main function
Hungary	135,000	Logistic center, cutting, and sewing
Bulgaria	78,000	Socks manufacturing

Capital Expenditures

The following table shows Delta Galil's fixed assets purchases 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.

	Year ended December 31,		
	2001	2002	2003
	(\$ in thousands)		
Israel	7,365	5,892	5,909
Egypt	3,992	2,899	3,927
Eastern Europe.....		2,553	3,246
United Kingdom.....	69	408	754
North America	1,129	5,156	525
Jordan	2,192	703	396
Others	<u>688</u>	<u>117</u>	<u>168</u>
	<u>15,435</u>	<u>17,728</u>	<u>14,925</u>

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 2003 increased by 2% and amounted to \$580.1 million compared to \$567.3 million in 2002.

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, 2001, 2002 and 2003:

	Year ended December 31,					
	2001		2002		2003	
	\$	%	\$	%	\$	%
North America	310.6	55.6	303.1	53.4	300.7	51.8
United Kingdom	156.8	28.1	181.3	32.0	187.9	32.4
Europe (excluding U.K.)	45.9	8.2	44.4	7.8	48.7	8.4
Israel	<u>45.5</u>	<u>8.1</u>	<u>38.5</u>	<u>6.8</u>	<u>42.8</u>	<u>7.4</u>
Total	<u>558.8</u>	<u>100.0</u>	<u>567.3</u>	<u>100.0</u>	<u>580.1</u>	<u>100.0</u>

In 2003, sales to North America decreased by 0.8% to \$300.7 million representing 51.8% of total sales. The decrease in sales to North America is attributed mainly to a weakness in Christmas and New Year sales. Delta Galil's sales to its top customer, the U.K. chain Marks & Spencer, increased by 2.8% to \$179.1 million in 2003 compared to \$174.2 million in 2002. The increase is attributed to the strengthening of the pound sterling 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 dollar. Delta Galil's sales to the Israeli market increased by 11.2% to \$42.8 million in 2003 compared to \$38.5 million in 2002.

In 2002, sales to North America decreased by 2.4% to \$303.1 million representing 53.4% of total sales. The decrease is attributed to a \$9.7 million decrease in sales to Kmart and \$8.1 million decrease in sales to DKNY due to its decision to exit from the men's category. Delta Galil's sales to its top customer, the U.K. chain Marks & Spencer, increased by 13.6% to \$174.2 million in 2002 compared to \$153.3 million in 2001. The increase is attributed to an overall increase in Marks & Spencer sales and to the strengthening of the pound

sterling versus the dollar. Delta Galil's sales to the Israeli market decreased by 15.4% to \$38.5 million in 2002 compared to \$45.5 million in 2001.

The following table shows Delta Galil's revenues by product categories, stated as a percentage of total revenues, for the years ended December 31, 2001, 2002 and 2003:

	Year ended December 31,		
	2001	2002	2003
Ladies' Intimate Apparel	57.6%	59.2%	61.1%
Socks	13.6	15.2	16.4
Men's Underwear.....	14.9	11.2	10.1
Babywear	5.8	7.2	6.8
Leisurewear.....	2.7	3.6	3.0
Fabrics and Others	5.4	3.6	2.6
Total	100%	100%	100%

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. The goodwill attributed to the purchase of Auburn Hosiery Mills amounted to approximately \$1.4 million.

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 has been allocated as part of the goodwill.

Acquisition of Wundies

In 2000, Delta Galil completed the acquisition of all of the share capital of Wundies Industries, Inc., a U.S. company, and its subsidiaries. Wundies produces private label ladies' intimate apparel and underwear and sleepwear for girls.

The acquisition price was \$29.1 million including \$1.0 million acquisition and issuance costs. In payment of the acquisition price, the shareholders of Wundies received 1,305,050 ordinary shares of Delta Galil representing approximately 6.5% of Delta Galil's issued share capital after the acquisition on a fully diluted basis. A total of 70,979 of these ordinary shares were allotted to certain Wundies employees pursuant to an employee stock plan adopted by Delta Galil. The excess of cost of acquisition over the fair value of net assets on acquisition date - \$15.6 million - is presented as goodwill. Pursuant to a related agreement, a representative

of Wafra Acquisition Fund 11, L.P., an investment fund which owned approximately 93.5% of Wundies, was appointed as a director of Delta Galil, for as long as Wafra continues to hold at least 50% of the ordinary shares of Delta Galil it received.

Acquisition of a 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.

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 from this transaction and a similar profit will be recognized in 2004.

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 exercise 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 an aggregate of 80,000 options to six employees at an exercise price of \$15.35. The options granted in May 2003 and in March 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:

	Year ended December 31,		
	2001	2002	2003
Revenues.....	100.0%	100.0%	100.0%
Cost of revenues	81.6	80.5	80.4
Gross profit.....	18.4	19.5	19.6
Selling, marketing, general, administrative, goodwill amortization and restructuring expenses	14.4	14.6	13.3
Operating income	4.0	4.9	6.3
Financial expenses – net.....	(0.9)	(1.0)	(0.9)
Other income– net	0.1	0.2	*
Income before taxes on income	3.2	4.1	5.4
Taxes on income.....	(1.1)	(1.0)	(1.2)
Income after taxes on income	2.1	3.1	4.2
Share in profits (losses) of associated companies – net.....	*	*	(0.1)
Minority interests– net.....	(0.1)	(0.2)	(0.1)
Net income.....	<u>2.0%</u>	<u>2.9%</u>	<u>4.0%</u>

* Less than 0.1%.

Segment Results

We have four principal segments: U.S. Mass Market, U.S. Upper Market, Europe, and Socks. The U.S. Mass Market segment, which manufactures ladies intimate apparel, generated approximately 38% of 2003 revenues. The US Upper Market segment, which manufactures ladies intimate apparel and men's underwear, generated approximately 11% of 2003 revenues. The European segment, which manufactures ladies intimate apparel, men's underwear and outerwear, babywear and leisurewear generated approximately 31% of 2003 revenues. The Socks segment, which manufactures ladies, men's and children's socks, generated approximately 16% of 2003 revenues. In addition, we also have a wholesale and retail operation in Israel, as well as textile infrastructure operations that primarily serve other segments, which are referred to collectively as "Other" in our segment report.

	Sales by Segment ¹		
	(\$ millions)		% Change
	2003	2002	
Europe			
U.S. Mass Market	\$ 219.0	\$ 202.0	8.4%
U.S. Upper Market	66.5	84.8	(21.6)
Europe	177.4	171.0	3.7
Socks	91.8	85.3	7.6
Other	69.4	76.3	(9.0)
Adjustments ¹	(44.0)	(52.1)	(15.5)
Total	<u>\$ 580.1</u>	<u>\$ 567.3</u>	<u>2.2%</u>

¹ Includes inter-segment sales.

² Adjustment includes results of hedging transactions and elimination of intersegment sales.

Sales by Segment

The increase in sales by the U.S. Mass Market 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			
	(\$ millions)		
	<u>2003</u>	<u>2002</u>	<u>% Change</u>
U.S. Mass Market	\$ 24.8	\$ 14.6	69.9%
U.S. Upper Market	(1.7)	(1.6)	(6.3)
Europe	4.5	10.2	(55.9)
Socks	9.3	8.1	14.8
Other	(5.1)	(5.1)	0
Adjustments ¹	5.0	1.6	--
Total	<u>\$ 36.8</u>	<u>\$ 27.8</u>	<u>32.4%</u>

¹ Includes mainly capital gains and the effect of hedging transactions.

Operating Income by Segment

The increase in operating income in the U.S. Mass Market segment resulted from an increase in sales in 2003, as well as the write-off of doubtful accounts receivable from Kmart 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 positive Adjustment in 2003 includes mainly a capital gain from the sale of real estate in London.

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 dollar.

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 2003 increased by 2.1% and amounted to \$466.3 million (80.4% of revenues) compared to \$456.7 million (80.5% 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 2.9% over 2002 and totaled \$113.8 million (19.6% of revenues), compared to \$110.6 million (19.5% of revenues) in 2002.

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 4.4 % to \$ 62.9 million (10.8% of revenues) in 2003 compared to \$60.2 million (10.6% 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 are comprised mainly of salaries and related expenses, entertainment and travel expenses, professional fees, doubtful accounts and bad debts, depreciation and amortization and other office expenses. General and administrative expenses decreased from \$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.

Goodwill amortization. Based on FAS 142, which Delta Galil adopted on January 1, 2002, goodwill with indefinite life 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, comprising mainly 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 and to the decrease in the general and administrative 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 composed mainly from interest and exchange differences.

Other income- net. Other income in 2003 decreased by \$0.7 million compared to 2002, 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 (losses) profits 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.

Year Ended December 31, 2002 Compared with Year Ended December 31, 2001 - Consolidated

Revenues. Total revenues in 2002 increased by 1.5% and amounted to \$567.3 million compared to \$558.8 million in 2001. Revenues in North America decreased by 2.4% and amounted to \$303.1 million in 2002 compared to \$310.6 million in 2001. The decrease is attributed to a decrease in Delta's North America sales to specialty and department stores, which dropped 11.5% in 2002 totaling \$101.1 million, compared to \$114.3 million in 2001, offset by revenues to the US mass market which increased 2.9% in 2002 totaling \$202.0 million, compared to \$196.3 million in 2001. The increase in revenues in the U.K. is attributed to an overall increase in Marks & Spencer sales and to the strengthening of the pound sterling against the US dollar. Revenues to the Israeli market dropped by 15.4% from \$45.5 million in 2001 to \$38.5 million in 2002. The decrease is attributed mainly to the devaluation of the NIS vs. the dollar, which resulted in a \$5.0 million decrease, and to the discontinuance of the consolidation of Edomit's results starting 2002, which resulted in a \$2.9 million decrease. Sales of seam-free products decreased from \$25.2 million in 2001 to \$18.3 million in 2002.

Cost of revenues. Cost of revenues in 2002 remain almost unchanged and amounted to \$456.7 million (80.5% of revenues) compared to \$455.7 million (81.6% of revenues) in 2001. Wages and salaries decreased by approximately 8% mainly due to the devaluation of the NIS versus the dollar. This decrease was offset mainly by a 3% increase in the cost of work performed by subcontractors and by \$2.0 million cost of cancellation of a contract with a supplier.

Gross profit. Gross profit in 2002 increased by 7.3% over 2001 and totaled \$110.6 million (19.5% of revenues), compared to \$103.0 million (18.4% of revenues) in 2001. The increase in the gross profit margin in 2002 resulted mainly from the strengthening of the pound sterling and the euro versus the dollar and the devaluation of the NIS versus the dollar in real terms, which contributed approximately 1.3% of sales, offset by \$2.0 million cancellation of a contract with a supplier.

Selling and marketing expenses. Selling and marketing expenses increased by 4.6 % to \$ 60.2 million (10.6% of revenues) in 2002 compared to \$57.6 million (10.3% of revenues) in 2001. The increase in selling and marketing expenses is attributed mainly to a \$3.1 million increase in transportation and delivery expenses, due to a decrease in product supply lead time, which requires the increase of air shipment rather than sea shipment.

General and administrative expenses. General and administrative expenses increased from \$20.8 million in 2001 to \$21.5 million in 2002. The increase in general and administrative expenses is attributed mainly to a \$0.9 million increase in wages and salaries and a \$0.4 million increase in provision for doubtful accounts offset by a decrease of \$0.5 million in capital gain from realization of fixed assets. General and administrative expenses in 2002 included a provision of \$2.6 million to write off doubtful accounts receivable from Kmart and a provision of \$0.9 to write off doubtful accounts receivable of an Israeli retail chain. In 2001, general and administrative expenses included a provision for doubtful accounts receivable of \$3.4 million, following the Kmart filing for Chapter 11 bankruptcy protection. The provisions made regarding Kmart debt reflect the expected settlement following the customer's forecasted emergence from Chapter 11. By doing so, Delta Galil has written off all the pre-petition outstanding receivables.

Goodwill amortization. Based on FAS 142, which Delta Galil adopted on January 1, 2002, goodwill with indefinite life is no longer amortized. Prior to January 1, 2002 Delta Galil amortized goodwill in equal annual installments usually over a period of 40 years. This amortization amounted to \$1.5 million in 2001. See "Critical Accounting Policies - Valuation of Intangible Assets-Goodwill".

Restructuring expenses. Restructuring expenses, comprising mainly expenses relating to the closure of sewing plants, increased from \$0.9 million in 2001 to \$1.1 million in 2002.

Operating income. Operating income in 2002 increased by 25.0% compared to 2001 and totaled \$27.8 million (4.9% of revenues) compared to \$22.2 million (4.0% of revenues) in 2001. The increase in the operating profit margin is primarily due to the increase in gross profit margin and due to the cancellation of the goodwill amortization.

Financial expenses – net. Financial expenses increased by 14.8% to \$5.5 million in 2002 from \$4.8 million in 2001. Interest expenses decreased by \$2.9 million, from \$7.2 million in 2001 to \$4.3 million in 2002, due to a decrease in interest rates. Exchange differences in 2002 amounted to an expense of \$1.2 million, compared to an income of \$2.4 million in 2001, mainly due to the devaluation of the NIS versus the dollar, and to the strengthening of the pound sterling and euro against the dollar.

Other income - net. Other income in 2002 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”.

Taxes on income. Income taxes for 2002 were provided for at an effective tax rate of 24.8% compared to 32.8% in 2001. The decrease in the effective tax rate in 2002 compared to 2001 is mainly due to an increase in pre-tax earnings of subsidiaries that are subject to lower tax rates.

Share in profits of associated companies. Delta Galil’s share in profits of associated companies amounted to \$0.2 million in 2002 compared to \$0.1 million in 2001.

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 2002 amounted to \$1.0 million. Minority interest in profit of subsidiaries – net in 2001 amounted to \$0.7 million and represented the minority share in profit of Century Wear and the share in Edomit results – a hotel activity, which Delta Galil ceased to consolidate starting in 2002.

Net Income. Net income in 2002 increased by 45.5% and totaled \$16.6 million (2.9% of sales) compared to \$11.4 million (2.0% of sales) in 2001.

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, 2003, 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 under the heading Cautionary Statement Regarding Forward-Looking Information and 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, 2003, based on the review made by Delta Galil, no impairment was required.

New Accounting Standards under US GAAP

FAS 143

In July 2001, the FASB issued FAS No. 143, “Accounting for Asset Retirement Obligations”. FAS 143 prescribes the accounting for obligations associated with retirement of tangible long-lived assets, including the timing of liability recognition and initial measurement of the liability. FAS 143 requires that an asset retirement cost should be capitalized as part of the cost of the related long-lived asset and subsequently allocated to expense using a systematic and rational method. FAS 143 will be effective for Delta Galil for the fiscal years that began January 1, 2003. The adoption of FAS 143 did not have a material effect on Delta Galil consolidated financial statements.

FAS 145

In April 2002, the FASB issued FAS No. 145, "Revision of FASB Statements Nos. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Connections". Among other amendments and rescissions, FAS 145 eliminates the requirement that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect, unless such gains and losses meet the criteria in paragraph 20 of Accounting Principles Board Opinion APB No. 30, "Reporting the Results of Operation - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". FAS 145 is partially effective for transactions occurring after May 15, 2002 and partially effective for fiscal years beginning after May 15, 2002.

The adoption of FAS 145 did not have a material effect on Delta Galil consolidated financial statements.

FAS 146

In June 2002, the FASB issued FAS No. 146 "Accounting for Costs Associated with Exit or Disposal activities". FAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities. FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as was the previous accounting policy. FAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

The adoption of FAS 146 did not have a material effect on Delta Galil consolidated financial statements.

FAS 148

In December 2002, the FASB issued FAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123". FAS 148 amends FAS 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require prominent disclosures in the financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of FAS 148 are effective for financial statements issued for fiscal years ending after December 15, 2002.

Delta Galil has elected to continue accounting for employee stock based compensation in accordance with APB 25 and related interpretations and has applied the disclosure provisions in FAS 148 in these consolidated financial statements and the accompanying notes. See note 1q to the consolidated financial statements.

The adoption of FAS 148 did not have a material effect on Delta Galil consolidated financial statements.

FIN 45

In November 2002, the FASB issued FASB Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FIN 45 requires the guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. It also elaborates on the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees that it has issued. Disclosures required under FIN 45 are already included in Delta Galil financial statements; however, the initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002.

The adoption of FIN 45 did not have a material effect on Delta Galil consolidated financial statements.

FIN 46

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," known as FIN 46. Under FIN 46, entities are separated into two groups: (1) those for which voting interests are used to determine consolidation, which is the most common situation, and (2) those for which variable interests are used to determine consolidation. FIN 46 explains how to identify Variable Interest Entities (VIEs) and how to determine when a business enterprise should include the assets, liabilities, noncontrolling interests, and results of activities of a VIE in its consolidated financial statements.

Since issuing FIN 46, the FASB has proposed various amendments to it and has deferred its effective dates. Most recently, in December 2003, the FASB issued a revised version of FIN 46, known as FIN 46-R, which also provides for a partial deferral of FIN 46. This partial deferral established the effective dates for public entities to apply FIN 46 and FIN 46-R based on the nature of the variable interest entity and the date upon which the public company became involved with the variable interest entity. In general, the deferral provides that (i) for variable interest entities created before February 1, 2003, a public entity must apply FIN 46-R at the end of the first interim or annual period ending after March 15, 2004, and may be required to apply FIN 46 at the end of the first interim or annual period ending after December 15, 2003, if the variable interest entity is a special purpose entity, and (ii) for variable interest entities created after January 31, 2003, a public company must apply FIN 46 at the end of the first interim or annual period ending after December 15, 2003, as previously required, and then apply FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

Delta Galil currently has no variable interests in any VIE. Accordingly, Delta Galil believes that the adoption of FIN 46 and FIN 46-R will not have material impact on its financial position, results of operations and cash flows.

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:

	Year ended December 31,		
	2001	2002	2003
	(\$ in millions)		
Net cash flow provided by operating activity.....	\$32.9	\$26.3	\$42.9
Net cash flow used in investing activity.....	(45.9)	(19.7)	(18.4)
Net cash flow provided by financing activity (excluding dividends to shareholders and cost of acquisition of treasury shares).....	23.9	10.5	(11.8)
Dividends to shareholders	(5.8)	(7.0)	(9.5)
Cost of acquisition of treasury shares.....	(1.0)	(8.4)	-
Increase in cash and cash equivalents.....	<u>\$4.1</u>	<u>\$1.7</u>	<u>\$3.2</u>

In 2001, 2002 and 2003 Delta Galil generated excess cash flow from operations of \$32.9 million, \$26.3 million and \$42.9 million respectively.

The increase in net cash flow provided by operating activity from \$26.3 million in 2002 to \$42.9 million in 2003 is mainly due to a decrease of \$15.1 million in accounts receivable during 2003 compared to an increase of \$10.5 million during 2002 and due to an increase of \$6.7 million in net income. This increase was partly offset by a decrease in accounts payable and accruals of \$5.1 million in 2003 compared to an increase of \$4.4 million in 2002.

Net cash flow used in investing activity in 2003 amounted to \$18.4 million compared to \$19.7 million in 2002. In 2003 net cash flow used in investing activity included \$10.1 million for the acquisition of Auburn Hosiery Mills and an additional payment of \$2.0 million for the acquisition of Inner Secrets, while in 2002 it included \$5.6 million for the acquisition of a logistic center in Hungary.

Net cash flow used in financing activity in 2003 amounted to \$11.8 million while in 2002 the net cash flow provided by financing activity amounted to \$10.5 million.

Debt

Set forth in the table below are Delta Galil's bank debt and debentures for the last three years.

	Year ended		
	<u>2001</u>	<u>2002</u>	<u>2003</u>
	(\$ in millions)		
Short-term:			
Bank loans.....	\$86.4	\$96.4	\$94.5
Current maturities of long-term loans	6.9	10.3	10.4
Debentures.....	0.6	-	-
Total Short-term.....	<u>93.9</u>	<u>106.7</u>	<u>104.9</u>
Long-term:			
Total Long-term bank loans.....	<u>25.2</u>	<u>23.0</u>	<u>13.6</u>
Total Debt.....	<u><u>\$119.1</u></u>	<u><u>\$129.7</u></u>	<u><u>\$118.5</u></u>

Delta Galil has incurred bank debt mainly for working capital, capital expenditures and general corporate purposes. Delta Galil's bank loans bear interest at annual rates ranging from approximately 2.5% to 2.9% (mainly 2.5%) 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 \$217.3 million of which, as of December 31, 2003, Delta Galil had \$98.8 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. Most of Delta Galil's borrowings are for shorter periods in order to maintain cash management flexibility. Long-term bank loans mature in periods up to February, 2009.

Delta Galil USA Inc. is a party to a credit agreement, which was amended as of June, 2003, 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 \$86 million in loans of which \$26 million are term loans and the remainder is revolving credit. The principal of the term loans are payable in 14 equal quarterly installment of approximately \$1.9 million each until December 1, 2005. As of December 31, 2003 \$31.4 million of this credit line was utilized.

Working Capital and Capital Expenditures

Working capital at December 31, 2003 was \$56.6 million, compared to \$67.9 million at December 31, 2002 due to the acquisition of Auburn Hosiery Mills as part of which Delta Galil made a provision of approximately \$6 million of restructuring expenses, which are recorded as current liabilities. Delta Galil believes that its working capital is sufficient for the company's present requirements. Delta Galil has no material commitment for capital expenditures.

Set forth below are our contractual obligations and other commercial commitments as of December 31, 2003:

Contractual Obligations	<u>Payments Due by Period</u>			
	<u>Total</u>	<u>Less than 1 year</u>	<u>2- 4 years</u>	<u>More than 5 years</u>
		(U.S. \$ in millions)		
Long-Term Debt.....	\$24.0	\$10.4	\$12.2	\$1.4
Capital Lease Obligations.....	1.1	0.1	0.2	0.8
Operating Leases.....	35.6	7.5	14.4	13.7
Letter of credits and bank guarantees.....	<u>35.0</u>	<u>28.2</u>	<u>4.2</u>	<u>2.6</u>
Total Contractual Cash Obligations.....	<u>95.7</u>	<u>46.2</u>	<u>31.0</u>	<u>18.5</u>

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	68	Chairman of the Board of Directors
Arnon Tiberg	60	President, Chief Executive Officer and General Manager
Yossi Hajaj	36	Chief Financial Officer
Aviram Lahav	45	Senior Vice President
Michael Fitzgerald	61	Senior Vice President
Yechiel Naor	55	Senior Vice President
Imad Talhami	45	Senior Vice President
Esti Maoz	56	Senior Vice President
Eytan Stiassnie	48	Senior Vice President
Aharon Dovrat	73	Director
R. Henry Kleeman ⁽³⁾	46	Director
Harvey M. Krueger	75	Director
Noam Lautman	35	Director
Giora Morag ^{(1) (2)}	59	Director
Amnon Neubach ^{(1) (2)}	59	Director
Peter Petrillo ⁽⁴⁾	43	Director
Dan Propper	63	Director
Zalman Shalev ⁽²⁾	81	Director
Amior Vinocourt ⁽²⁾	77	Director
J. Randall White ⁽³⁾	49	Director
Ann E. Ziegler ⁽³⁾	46	Director

(1) External Director.

(2) Member of the Audit Committee.

(3) Mr. R. Henry Kleeman, Mr. J. Randall White and Ms. 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.

(4) Mr. Peter Petrillo is a nominee of Wafra Investment Advisory Group, Inc. pursuant to a Letter Agreement by and among Sara Lee, the Lautman Group and Wafra Investment Advisory Group, Inc.

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 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 and CEO of Delta Galil's Innerwear USA operations since March 2004. 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 has served as CEO of Delta Galil USA since 1999, 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.

Yecheil Naor joined Delta Galil in 1997 as the General Manager of the Textile Operation. In 2002 he was promoted to Senior Vice President. From 1984 until 1996 he served as VP and General Manager of Malden Mills Industries in Lawrence, Mass. From 1973 to 1984 Mr. Naor served as Division Manager and Technical Director of Argaman Industries in Israel. Mr. Naor holds an MSc in Textile Chemistry, Plastics and Polymers and BSc Degree in Chemistry and Physics from the Hebrew University in Jerusalem.

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 BSc 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.

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.

Aharon Dovrat has served as a Director of Delta Galil since December 1998. Mr. Dovrat is the chairman of Dovrat & Co. Ltd. and Isal Ltd. . Mr. Dovrat serves as a Director of Cognifit Ltd., DS Polaris Ltd., Technomatix Technologies Ltd. and Solgood Communication 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.

R. Henry Kleeman has served as a Director of Delta Galil since June 2000. Mr. Kleeman is a Vice President, Deputy General Counsel and business practices officer of Sara Lee Corporation, where he has served as an attorney since 1995. Mr. Kleeman also serves as a director of several Sara Lee subsidiaries. Mr. Kleeman earned a bachelor of arts degree in English and economics from Colgate University and a J.D. from the University of Chicago Law School.

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 Beth Hatefutsoth 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 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 and Aspen Building and Development Ltd. (TASE: ASBD), a real estate company and as a director of Arelnet Ltd. (TASE: ARNT), a VOIP switch company; Zika Electrode Works Ltd. (TASE: ZIKA), a manufacturer of electrodes and safety tools; Orbit Alchut Technologies Ltd. (TASE: ORBI), an antenna company and 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.

Peter Petrillo has served as a Director of Delta Galil since September 2000. Mr. Petrillo is the Senior Managing Director of Wafra Partners LLC and is a Director of Riviera Trading, Inc., Holiday Group Inc., Travelpro International, Inc., Altec Lansing Technologies, Inc., Vulcan Engineering Co., Kenexa Corporation, MariTEL, Inc., Casiano Communications, Inc., and The Mitchell Gold Co. Mr. Petrillo was a member of the Board of Directors of Three V Health, Inc., Deliland Foods Corporation, Atlantic Express Transportation Corp., and Phoenix Waste Services Company, Inc.

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.

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 the Sara Lee Bakery Group. 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 \$8,000 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 2003, Delta Galil's expenses for directors' compensation amounted to a total of approximately \$90,000.

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, 2003.

	<u>Salaries, Directors' Fees, Commissions and Bonuses</u>	<u>Pension, Retirement and Similar Benefits</u>
All directors and executive officers (consisting of 22 persons)	\$3.4 million	\$0.3 million

As of June 15, 2004, 657,713 options to purchase Delta Galil's ordinary shares were outstanding to certain executive officers and key employees (consisting of 8 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, 2003, Delta Galil employed approximately 12,150 employees of these, 10,000 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, 2003:

<u>Country</u>	<u>Number of Employees</u>
Egypt	3,850
Israel	2,930
Jordan	2,360
Honduras	1,170
United States	780

United Kingdom	418
Hungary	370
Canada	230
Other	<u>42</u>
Total	<u>12,150</u>

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. 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. 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. 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 April 15, 2004.

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, 2003, Delta Galil had outstanding under this plan options to purchase up to 107,452 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, 2003 all of the said options are fully vested. As of December 31, 2003, 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 15, 2004, 118,750 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. In March 2004 the Company granted 80,000 options to six employees of the group at an exercise price of \$15.35. 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.

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 15, 2004 options to purchase an additional 64,500 shares remain available for grant under the plan. As of June 15, 2004, 79,000 options that were granted to nine employees were forfeited upon the termination of their employment.

As of June 15, 2004, 1,862,063 options to purchase Delta Galil's ordinary shares were outstanding to certain executive officers and key employees (consisting of 108 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 15, 2004, 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⁽¹⁾</u>
Dov Lautman ⁽²⁾	4,644,993	25.2%
Sara Lee International Corporation	4,256,537	23.1%
Wafra Acquisition Fund 11, L.P.	1,123,010	6.1%
Arnon Tiberg ⁽³⁾	493,084	2.7%
Amior Vinocourt ⁽⁴⁾	63,501	0.3%
Aharon Dovrat	10,050	0.05%
Harvey Krueger	5,000	0.03%

(1) Based on 18,458,864 ordinary shares outstanding, excluding 1,422,486 ordinary shares held by the Company and excluding 66,499 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'lakucan 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.

In addition, the Lautman Group, Sara Lee Corporation and Sara Lee International Corporation are parties to a Letter Agreement with Wafra Investment Advisory Group, Inc. dated as of September 11, 2000.

Pursuant to the Letter Agreement, which was entered into in connection with the acquisition of Wundies Industries Inc., Mr. Lautman agreed to nominate a person designated by Wafra Acquisition Fund 11, L.P. and approved by Delta Galil, as one of the nominees that Mr. Lautman is entitled to nominate to the board of directors under the shareholders agreement described above. Each of the Lautman Group, Sara Lee Corporation and Sara Lee International Corporation agreed to vote in favor of such appointment. Wafra's nominee shall serve on Delta Galil's board of directors for a period of two years or as long as Wafra continues to hold at least 50% of the ordinary shares of Delta Galil it received in consideration for its sale of shares of Wundies Industries, Inc.

As of June 15, 2004, the Lautman Group owned 25.2% and Sara Lee owns 23.1% of the outstanding ordinary shares of Delta Galil.

As of June 15, 2004, Delta Galil has 25 shareholders of record resident in the United States, accounting for 30.8% of the outstanding ordinary shares. Two U.S. shareholders, Sara Lee International Corporation and Wafra Acquisition Fund 11 L.P., hold 29.2% of the outstanding ordinary shares.

Related Party Transactions

Sales to Sara Lee Affiliates

Delta Galil derived 0.4% of its revenues in 2003 from sales to subsidiaries of Sara Lee that own or license brands, such as Dim, Playtex and Polo Ralph Lauren. 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.

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:

Year Ended December 31			
<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
<u>\$0.37</u>	<u>\$0.30</u>	<u>\$0.37</u>	<u>\$0.52</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 depositary. The Bank of New York's address is 101 Barclay Street, New York, New York 10286. On March 25, 1999, trading of Delta Galil's ADSs commenced on the Nasdaq National Market under the symbol DELT.

The table below sets forth for the periods indicated (i) the high and low last reported prices of the ordinary shares (in nominal NIS and dollars) on the TASE, and (ii) the high and low sales prices of the ADSs as reported on the Nasdaq since March 1999. The translation into dollars is based on the daily representative rate of exchange on the last day of each period, as published by the Bank of Israel.

	Ordinary Shares				ADS Equivalents	
	High		Low		High	Low
	NIS	\$	NIS	\$	\$	\$
Year Ending December 31, 1998:	40.00	10.94	11.45	3.24	-	-
Year Ending December 31, 1999:	75.60	18.20	33.44	8.19	17.47	8.84
Year Ending December 31, 2000:	101.57	24.98	48.05	11.71	25.19	11.75
Year Ending December 31, 2001:						
First Quarter	59.18	14.38	51.12	12.40	14.63	12.06
Second Quarter	55.76	13.45	34.63	8.30	13.82	8.20
Third Quarter	44.07	10.41	33.33	7.64	10.46	7.58
Fourth Quarter.....	45.44	10.36	34.40	7.90	10.10	7.62
Year Ending December 31, 2002:						
First Quarter	49.35	10.99	35.10	7.52	10.83	7.85
Second Quarter	37.50	7.84	32.89	6.76	7.73	6.69
Third Quarter	40.10	8.59	34.79	7.18	8.40	6.86
Fourth Quarter.....	47.20	10.19	32.91	6.77	10.26	6.69
Year Ending December 31, 2003:						
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
Most Recent Six Months:						
December 2003	74.90	16.89	68.70	15.73	16.62	15.28
January 2004	74.30	16.88	68.50	15.38	16.16	15.18
February 2004	73.20	16.32	67.10	14.99	15.88	14.88
March 2004	73.18	16.32	66.20	14.68	15.98	14.71
April 2004	72.30	15.74	69.20	15.23	15.88	14.88
May 2004	72.17	15.80	66.90	14.57	15.65	14.20

As of June 13, 2004, the last reported price of the ordinary shares on the TASE was NIS 68.62 (\$15.76) and on June 10, 2004 the last reported price per ADS on Nasdaq was \$ 14.70.

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, or any corporation in which he is a 5% or greater shareholder, director or general manager or has the right to appoint at least one director or the general manager, may have, and all related 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, other than directors, 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. 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 General Manager, CEO and/or President, are at the discretion of the General Manager of Delta Galil.

Audit Committee Approval

The Companies Law requires approval by both the audit committee and the board of directors of, among other things, the following actions or transactions:

- proposed transactions in which an office holder has a direct or indirect personal interest and which is outside 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
- actions which may otherwise be deemed to constitute a breach of fiduciary duty of any office holder of the company, that are done in good faith and that are in the interest of the company.

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 is an exemption in the Companies Law or in the regulations promulgated thereunder:

- an extraordinary transaction between a public company and a controlling shareholder;
- an extraordinary transaction with a third party in which a controlling shareholder of the company has a personal interest;
- the terms of compensation of a controlling shareholder, if he is an employee of the company;
- terms of service of directors (including terms of their employment as officers of the company); and
- the terms of office of a controlling shareholder if he is an office holder of the company.

The shareholder approval for such an extraordinary transaction must include at least one-third of the shareholders who have no personal interest in the transaction and are present at the meeting, not including abstentions. The transaction can be approved by shareholders without this 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 the Articles 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 sum or sums in such manner, at such times and upon such terms and conditions as it deems fit and, in particular, by the issue of bonds, perpetual or redeemable debentures, debenture stock, or any mortgages or charges, on the whole or any part of the property of Delta Galil, both present and future, 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. 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 50% of the voting rights of the company.

The Companies Law provides that mergers require the approval of the board of directors and shareholders of the merging parties. 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. The Articles provide that shareholder approval of mergers will be by a simple majority vote cast at a general meeting of shareholders, not taking abstentions into account.

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 preceding annual general meeting, and such place as determined by the board of directors. The board of directors may call extraordinary general meetings of shareholders and are obligated to do so upon a written request in accordance with the Companies Law. The Companies Law provides that an extraordinary general meeting of shareholder may be called by the board of directors or by a request of 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 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 forty days before the date of the meeting.

Directors

Election of Directors

Delta Galil's ordinary shares do not have cumulative voting rights in 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 earlier removal or resignation. A director is not required to retire at a certain age and need not be a shareholder of Delta Galil.

Meetings of the Board of Directors

The required quorum for any Board meeting is not less than thirty percent (30%) of the then 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, if declared. Delta Galil may declare a dividend to be paid to the holders of ordinary shares according to 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 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."

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."

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 structure applicable to corporations in Israel, with special reference to its effect on Delta Galil. 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 Israeli corporate tax rate since 1996 has been 36%. However, part of Delta Galil's Israeli income, which is derived from Approved Enterprises, is subject to lower tax rates, as described below.

Law for the Encouragement of Industry (Taxes), 1969 (the "Industry Encouragement Law")

Delta Galil and its Israeli subsidiary currently qualify as "Industrial Companies" pursuant to the Industry Encouragement Law. As such, Delta Galil and its subsidiary qualify for certain tax benefits, including:

- special depreciation rate for machinery, equipment and buildings used by an Industrial Enterprise. ;
- consolidated tax returns can be filed with its Industrial Companies' subsidiary. Delta Galil files consolidated tax returns with one of its subsidiaries;
- expenses incurred in connection with the issuance of publicly-traded shares may be deducted at a rate of 33.33% per annum over a period of three years from the time the expenses were incurred.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any government authority. However, no assurance can be given that Delta Galil or any of its Israeli subsidiaries that presently qualify as "Industrial Companies" 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")

Delta Galil has been granted the status of an "Approved Enterprise" under the Investment Law. Pursuant to this law, capital investments in production facilities, upon application to the Israeli Investment Center, may 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. Each application to the Investment Center is reviewed separately, and a decision as to whether or not to approve the application is based, among other things, on the then prevailing criteria set forth in the Investment Law, on the specific objectives of the applicant company and on financial criteria of the applicant company.

An Approved Enterprise is entitled to benefits, including Israeli government cash grants and tax benefits, for the increase in its revenues deriving from the approved investments.

Delta is a "Foreign Investors Company" ("FIC"), as defined by the Investment Law, and is entitled to calculate its taxable income according to changes of the dollar exchange rate. Delta 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. Unless extended, benefits under the Investment Law are granted to enterprises seeking approval not later than June 30, 2004.

Delta Galil has four uncompleted Approved Enterprises plans. Income derived from an Approved Enterprise is regularly subject to tax at the rate of 25% rather than the usual rate of 36% for a period of seven to ten years commencing with the year in which the Approved Enterprise first generates taxable income. This period of benefits may not exceed 12 years from the year of commencement of operations or 14 years from the year in which approval was granted, whichever is earlier. Some of the Approved Enterprises are eligible for tax exemption for the first two years in which they generate taxable income.

Delta Galil first derived income from some of the abovementioned Approved Enterprises in 1998 and 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 1998 and in the years 2000 - 2003, Delta Galil had not used any of the tax benefits to which it is entitled under these government programs in these years. The remaining tax benefits may be available for use in future years.

Under the Approved Enterprise programs, Delta Galil has received grants totaling \$ 1.2 million in 2001, \$ 1.6 million in 2002 and \$1.1 million in 2003. 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.

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.

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 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 rate of 36%. 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.

Israel presently has no estate or gift tax. Starting January 2003, a capital gain tax will be imposed in case of gift from an Israeli resident to a non-Israeli resident.

Recent 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.

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.

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 which 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

Special U.S. federal income tax rules apply to U.S. Holders owning shares of a so-called “passive foreign investment company” (“PFIC”). A foreign corporation will be considered a PFIC for any taxable year in which 75% or more of its gross income consists of certain types of passive income or 50% or more of the average value of its assets consists of “passive assets” (generally, assets that generate passive income). Based upon an analysis of Delta Galil’s financial position, Delta Galil believes that it has not ever been a PFIC and does not expect to become a PFIC for its current tax year. While Delta Galil intends to manage its business so as to avoid PFIC status, to the extent consistent with its other business goals, no assurances can be made that the business plans of Delta Galil will not change in a manner that may affect its PFIC status determination. Were Delta Galil classified as a PFIC, a U.S. Holder could be subject to increased tax liability (possibly including an interest charge) upon the sale or other disposition of ADSs or ordinary shares or upon the receipt of amounts treated as “excess distributions.”

Backup Withholding

A U.S. Holder may be subject to backup withholding at the rate of 30% with respect to dividends on, and the proceeds from dispositions of, ADSs or ordinary shares. In general, backup withholding will apply to a U.S. Holder only if the U.S. Holder fails to comply with certain identification procedures or fails to report properly payments of dividends. Backup withholding will not apply with respect to payments made to certain exempt recipients, such as corporations and tax-exempt organizations. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. Holder, provided that the required information is furnished to the Internal Revenue Service.

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 2003, Delta Galil derived 32% of its revenues from customers in pound sterling, 7% of its revenue were in NIS, and 8% were in euros. More than 10% of Delta Galil's expenses were in NIS in 2003.

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, 2003, Delta Galil had entered into hedging transactions for the exchange of \$30 million into pound sterling at an average rate of \$1.64 per pound sterling for the first two quarters of 2004. As of June 1, 2004 Delta Galil had executed additional hedging transactions for the exchange of \$35 million into pound sterling at an average rate of \$1.84 per pound sterling and for the exchange of \$10 million into Euro at an average rate of \$1.28 per Euro for the second and the third quarters of 2004.

In 2003, Delta Galil carried out sales of the pound sterling in the amount of \$45 million. The loss on these transactions amounted to \$1.8 million. \$1.3 million of that loss is reflected in revenues, and \$0.5 million, which reflects the ineffective portion of changes in the fair value is presented among financial expenses. As mentioned above, as of December 31, 2003 Delta Galil also carried out sales of the pound sterling in the amount of \$30 million, which will be realized in 2004. The finance expenses relate to these transactions amounted to \$0.2 million. In addition, Delta Galil adjusts the linkage basis of the bank credit it utilizes according to the proportions between the currencies that make up its net income.

Based on current sales volumes, expenses and exchange rates, each one percent devaluation in pound sterling against the dollar would result in a decrease of approximately \$1.2 million in Delta Galil's yearly operating income, and a strengthening of the pound sterling would have the opposite effect. Each one percent appreciation of the NIS against the dollar would result in a decrease of \$0.5 million in yearly operating income, and a devaluation of the NIS would have the opposite effect.

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(s) and 14 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>2002</u>	<u>2003</u>
Audit fees	\$366,150	\$385,660
Tax fees	<u>89,500</u>	<u>75,000</u>
Total	<u>455,650</u>	<u>460,660</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 of Independent Auditors

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 auditors 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.

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

(a) <u>Index to Consolidated Financial Statements</u>	<u>PAGE</u>
Report of Independent Auditors	F-2
Consolidated Statements of Income for the Years Ended December 31, 2001, 2002, and 2003	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, 2001, 2002 and 2003	F-6
Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2002 and 2003	F-7
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 (b) <u>Exhibits</u>	
1.1 Memorandum of Association, as amended**	
1.2 Articles of Association**	
2.1 Form of Deposit Agreement and ADR*	
4.1 Agreement and Plan of Merger dated as of June 30, 2000 by and among W.I.I. Acquisitions Corp., Wundies Industries, Inc., Wafra Acquisition Fund 11, L.P., Michael Fitzgerald, William Mull, Judith Moore, Steven Lockcuff and Francis Tam.**	
4.2 Stock Purchase Agreement dated as of December 20, 2000 by and among Norton Sloan, Melissa Miller, Diana Baradarian and Jack Thekkekara, as Selling Shareholders, and Delta Galil Industries Ltd. and Wundies Industries, Inc., as Purchaser, relating to the acquisition of Inner Secrets Inc.**	
4.3 Credit and Security Agreement dated as of September 11, 2000 by and among Wundies Enterprises, Inc. and Wundies Industries, Inc., as Borrowers; Bank Leumi USA and Bank Hapoalim B.M., as Lenders and Bank Leumi USA, as Agent.**	
4.4 Amendment dated as of April 23, 2003 by and among Norton Sloan, Melissa Miller, Diana Baradarian and Jack Thekkekara, as Selling Shareholders, and Delta Galil Industries Ltd. and Delta Galil USA Inc., as Purchaser relating to the acquisition of Inner Secrets Inc. *****	
4.5 Amendment dated as of June 14, 2002, by and among Delta Galil USA Inc., Bank Leumi USA and Bank Hapoalim B.M., to the Credit and Security Agreement dated as of September 11, 2000, and related promissory notes.****	
4.6 Option Plan to 13 employees of Delta Galil and/or its subsidiaries*	
4.7 Option Plan to Arnon Tiberg*	
4.8 Option Plan to 70 employees of Delta Galil and/or its subsidiaries***	
4.9 Delta Galil Industries Ltd. 2002 Share Option Plan*****	
4.10 Form of Indemnification Undertaking*****	
4.11 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	
8.1 List of subsidiaries	
14.1 Consent of PricewaterhouseCoopers LLP	
14.2 Consent of Baker Tilly	
14.3 Consent of Ernst and Young	

- 12.1 Section 302 Certification of Arnon Tiberg
- 12.2 Section 302 Certification of Yossi Hajaj
- 13.1 Section 906 Certification of Arnon Tiberg
- 13.2 Section 906 Certification of Yossi Hajaj

* 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 28, 2002 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.

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 22, 2004

EXHIBIT 4.11

Auburn Agreement

List of Significant Subsidiaries

Company	Place of Incorporation	Ownership Interest
Delta Galil USA. Inc.	Delaware, U.S.A.	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%
Delta Galil Hungary KFT	Hungary	100%
Sport Socks Co. Ltd	Ireland	100%
Delta Textile Marketing Ltd.	Israel	100%
Delta Textile (New York) Ltd.	New York, U.S.A.	100%
Delta Elastic Tapes Industries, Ltd.	Israel	90%
Auburn Hosiery Mills Inc.	USA	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 22, 2004

/s/ Arnon Tiberg
Chief Executive Officer

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 22, 2004

/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, 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 22, 2004

/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 22, 2004

/s/ Yossi Hajaj
Name: Yossi Hajaj
Title: Chief Financial Officer

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2003

DELTA GALIL INDUSTRIES LTD.
(An Israeli corporation)
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2003

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

REPORT OF INDEPENDENT AUDITORS

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, 2003 and 2002 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, 2003. 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 18% and 25% of total consolidated assets as of December 31, 2003 and 2002, respectively, and whose revenues included in consolidation constitute approximately 2%, 10% and 30% of total consolidated revenues for the years ended December 31, 2003, 2002 and 2001, respectively. We did not audit the financial statements of associated companies, the Company's investment in which, as reflected in the balance sheets as of December 31, 2003 and 2002 is \$ 661,000 and \$ 4,207,000, respectively, and the Company's share in profit (loss) of which is an amount of \$ (300,000), \$158,000 and \$ 110,000 in 2003, 2002 and 2001, respectively. The financial statements of those subsidiaries and associated companies were audited by other independent auditors, 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 auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting oversight Board auditing standards generally accepted in Israel and in the United States of America, 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 independent auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other independent auditors, 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, 2003 and 2002, 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, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1h, effective January 1, 2002 the Company changed its method of accounting for goodwill to conform with FASB Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets".

Tel-Aviv, Israel
June 16, 2004

Kesselman & Kesselman
Certified Public Accountant (Isr.)

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

	Year ended December 31		
	2003	2002	2001
Net revenues	\$580,130	\$567,298	\$558,763
Cost of revenues	466,378	456,738	455,726
Gross profit	113,752	110,560	103,037
Selling, marketing, general and administrative expenses - net	79,574	81,635	77,872
Gain (loss) on sale of assets and subsidiary shares	3,645	(92)	(553)
Amortization of goodwill			1,505
Restructuring expenses	1,007	1,065	900
Operating income	36,816	27,768	22,207
Financial expenses - net	5,637	5,456	4,751
Other income - net	252	960	463
Income before taxes on income	31,431	23,272	17,919
Taxes on income	7,340	5,779	5,876
	24,091	17,493	12,043
Share in profits (losses) of associated companies - net	(300)	158	110
Minority interests, net	(439)	(1,025)	(729)
Net income	<u>\$23,352</u>	<u>\$16,626</u>	<u>\$11,424</u>
Earnings per share:			
Basic	<u>\$1.28</u>	<u>\$0.88</u>	<u>\$0.60</u>
Diluted	<u>\$1.24</u>	<u>\$0.88</u>	<u>\$0.60</u>
Weighted average number of shares (in thousands):			
Basic	<u>18,313</u>	<u>18,914</u>	<u>19,175</u>
Diluted	<u>18,763</u>	<u>18,927</u>	<u>19,199</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)

	December 31	
	2003	2002
A s s e t s		
Current assets:		
Cash and cash equivalents	\$ 17,699	\$ 14,491
Accounts receivable:		
Trade	85,723	95,601
Other	10,662	9,314
Inventories	142,984	133,363
Deferred income taxes	5,464	8,311
Other investment (2002 – an associated company), see note 3a	1,682	1,682
T o t a l current assets	<u>264,214</u>	<u>262,762</u>
Investments and long-term receivables:		
Associated companies and other investments	661	3,656
Funds in respect of employee rights upon retirement	6,161	5,218
Deferred income taxes		745
Long-term receivables, net of current maturities	419	350
	<u>7,241</u>	<u>9,969</u>
Property, plant and equipment, net of accumulated depreciation and amortization	<u>124,877</u>	<u>121,601</u>
Goodwill	<u>54,358</u>	<u>46,290</u>
Deferred charges, net of accumulated amortization	<u>194</u>	<u>436</u>
T o t a l assets	<u><u>\$ 450,884</u></u>	<u><u>\$ 441,058</u></u>

D. Lautman
Chairman of the Board

A. Tiberg
CEO

G. Morag
Director

	December 31	
	2003	2002
Liabilities and shareholders' equity		
Current liabilities:		
Short-term bank credit	\$94,560	\$96,413
Current maturities of long-term bank loans and other liabilities	10,436	10,257
Accounts payable and accruals:		
Trade	54,464	61,788
Other	48,142	26,359
T o t a l current liabilities	<u>207,602</u>	<u>194,817</u>
Long-term liabilities:		
Bank loans and other liabilities, net of current maturities	14,709	24,180
Liability for employee rights upon retirement	6,732	6,359
Deferred income taxes	6,300	14,371
T o t a l long-term liabilities	<u>27,741</u>	<u>44,910</u>
Commitments and contingent liabilities , see note 9		
T o t a l liabilities	<u>235,343</u>	<u>239,727</u>
Minority interests	<u>3,207</u>	<u>3,502</u>
Shareholders' equity:		
Ordinary shares of NIS 1 par value		
December 31, 2003 and 2002:		
Authorized - 26,000,000 shares;		
Issued – 19,947,849 shares and 19,780,549 shares respectively;		
Issued and paid -19,860,211 shares and 19,680,102 shares,		
respectively	21,830	21,792
Additional paid-in capital	99,735	98,030
Retained earnings	104,607	90,748
Accumulated other comprehensive loss	(2,503)	(1,406)
Treasury shares, at cost (1,422,486 shares)	(11,335)	(11,335)
T o t a l shareholders' equity	<u>212,334</u>	<u>197,829</u>
T o t a l liabilities and shareholders' equity	<u>\$450,884</u>	<u>\$441,058</u>

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)

	<u>Share capital</u>		<u>Additional paid-in capital</u>	<u>Deferred compensation</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Treasury shares, at cost</u>	<u>Total</u>
	<u>Number of shares</u>	<u>Par value</u>						
	<u>In thousands</u>							
BALANCE AT JANUARY 1, 2001	19,216	\$21,679	\$92,138	\$(20)	\$73,730		\$(2,080)	\$185,447
CHANGES DURING 2001:								
Net income					11,424			11,424
Gains in respect of derivative instruments designated as a cash-flow hedge (net of related tax of \$101,000)						225		<u>225</u>
Total comprehensive income								11,649
Exercise of employee stock options	8	2	62					64
Issuance of share capital (see note 2)	454	111	5,814					5,925
Amortization of deferred compensation related to stock option grants to employees and the Company's CEO				20				20
Cash dividend (\$0.30 per share)					(4,056)			(4,056)
Cost of acquisition of treasury shares							(860)	(860)
BALANCE AT DECEMBER 31, 2001	19,678	21,792	98,014	-;-	81,098	225	(2,940)	198,189
CHANGES DURING 2002:								
Net income					16,626			16,626
Losses in respect of derivative instruments designated as a cash-flow hedge (net of related tax of \$363,000)						(808)		(808)
Additional minimum pension liability adjustment (net of related tax of \$540,000)						(823)		<u>(823)</u>
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)
BALANCE AT DECEMBER 31, 2002	19,680	\$21,792	\$98,030		\$90,748	\$(1,406)	\$(11,335)	\$197,829
CHANGES DURING 2003:								
Net income					23,352			23,352
Losses in respect of derivative instruments designated as a cash-flow hedge (net of related tax of \$485,000)						(1,134)		(1,134)
Differences from translation of foreign currency financial statements of a subsidiary						*		*
Additional minimum pension liability adjustment (net of related tax of \$25,000)						37		<u>37</u>
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)
BALANCE AT DECEMBER 31, 2003	19,861	\$21,830	\$99,735		\$104,607	\$(2,503)	\$(11,335)	\$212,334

* 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)

	Year ended December 31		
	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$23,352	\$16,626	\$11,424
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	439	1,025	729
Share in losses (profits) of associated companies, net	300	(158)	(110)
Amounts carried to deferred charges		(146)	(414)
Depreciation and amortization	14,530	14,082	13,946
Write-down of other investments	634		
Amortization of goodwill			1,505
Deferred income taxes – net	(3,555)	440	1,630
Restructuring expenses	194	414	94
Changes in accrued liability for employee rights upon Retirement	409	96	(647)
Loss on amounts funded in respect of employee rights upon retirement	214	624	180
Capital loss (gain) on sale of property, plant and equipment	(3,536)	313	947
Gain from sale of subsidiary shares	(109)		
Capital gain from realization of investment in an associated company	(885)	(960)	
Erosion of long-term receivables	(30)		
Exchange differences (erosion) of principal of long-term bank loans and debentures – net	1,043	28	(450)
Amount charged to capital surplus in respect of amortization of deferred compensation related to stock options grants to employees and the Company's CEO			20
	<u>9,648</u>	<u>15,758</u>	<u>17,430</u>
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable	15,095	(10,493)	17,030
Increase (decrease) in accounts payable and accruals	(5,061)	4,425	(10,418)
Increase in inventories	(173)	(35)	(2,577)
	<u>9,861</u>	<u>(6,103)</u>	<u>4,035</u>
Net cash provided by operating activities – forward	<u>\$42,861</u>	<u>\$26,281</u>	<u>\$32,889</u>

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

	Year ended December 31		
	2003	2002	2001
Brought forward	\$42,861	\$26,281	\$32,889
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of subsidiaries ⁽¹⁾	(10,101)	(5,600)	(33,789)
Additional payment allocated to goodwill	(2,003)		
Purchase of property, plant and equipment	(14,925)	(17,728)	(15,435)
Investment grants relating to property, plant and equipment	1,099	1,591	1,232
Other investments		(17)	
Proceeds from sale of property, plant and equipment	6,091	494	1,379
Proceeds from realization of investment in an associated Company	2,567	2,480	1,034
Proceeds from sale of subsidiary shares	250		
Associated company consolidated in previous years ⁽²⁾		(2)	
Loans granted to employees	(350)	(408)	(545)
Collection of employees loans	345	400	560
Long term loans granted	(221)	(270)	(225)
Amounts funded in respect of employee rights upon retirement – net	(1,157)	(686)	(106)
Net cash used in investing activities	(18,405)	(19,746)	(45,895)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Cost of acquisition of treasury shares		(8,356)	(860)
Long-term bank loans and other long-term liabilities		11,000	20,178
Decrease in long-term loans and other long-term liabilities	(10,335)	(10,391)	(8,184)
Dividend to the Company's shareholders	(9,493)	(6,976)	(5,807)
Dividend to minority shareholders in a subsidiary	(778)	(500)	(280)
Short-term bank credit – net	(2,067)	10,401	12,024
Proceeds from exercise of options granted to employees and the company's CEO	1,425	16	64
Net cash provided by (used in) financing activities	(21,248)	(4,806)	17,135
TRANSLATION DIFFERENCES ON CASH OF FOREIGN CURRENCY CONSOLIDATED SUBSIDIARY	*		
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,208	1,729	4,129
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	14,491	12,762	8,633
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$17,699</u>	<u>\$14,491</u>	<u>\$12,762</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)

	Year ended December 31		
	2003	2002	2001
SUPPLEMENTARY DISCLOSURE OF CASH FLOW INFORMATION - CASH PAID DURING THE YEAR FOR:			
Interest	\$3,660	\$3,870	\$6,462
Income taxes	\$9,478	\$6,748	\$7,019

(1) Acquisition of subsidiaries, see also note 2:

Assets and liabilities of the subsidiaries upon acquisition:			
Working capital (excluding cash and cash equivalents)	\$2,091	\$500	\$14,876
Long-lived assets	6,642	4,347	1,267
Goodwill arising on acquisition	1,368	753	24,311
Cost of investments	10,101	5,600	40,454
Issuance of shares			(5,925)
Amount payable			(740)
Cash paid – net	\$10,101	\$5,600	\$33,789

(2) Associated company previously consolidated:

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:

- (1) In 2003 the group recorded additional \$6.7 million as an adjustment to the purchase price of Inner Secrets, which was allocated to goodwill. This amount will be paid in 2004, see note 2c.
- (2) In 2003, 2002 and 2001, the net changes in outstanding balances of trade payables in respect of the purchase of property, plant and equipment were an increase (decrease) of \$ (1.1) million, \$ 0.2 million and \$ 0.5 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 four reportable operating segments - U.S. mass market, U.S. upper market, Europe and Socks. As to the Group’s segments and principal markets see note 16.

Most of the marketing operations of intimate apparel are performed through wholly owned subsidiaries.

A significant portion of the Group’s revenues derives from three principal customers. See note 13a and 16b.

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 “\$”). Most of the Group’s sales are made outside Israel, mainly to the United States (in dollars) and to the United Kingdom (in pounds sterling). The Company uses foreign currency derivatives in order to effectively change the cash flows resulting from sales in pounds sterling into dollars. Most of the materials consumed by the Company and its subsidiaries (which represent most of the Company and its subsidiaries’ production costs) are purchased in dollars. Thus, the functional currency of the Company and these subsidiaries is the dollar. Most of the financing of the group are carried in dollars.

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):

Transactions and balances originally denominated in dollars are presented at their original amounts. Balances in non-dollar currencies are translated into dollars using historical and current exchange rates for non-monetary and monetary balances, respectively. For non-dollar transactions reflected in the statements of income, the exchange rates at transaction dates are used, except for expenses deriving from non-monetary items, which are translated using historical exchange rates. The resulting currency transaction gains or losses are carried to “financial expenses-net”.

The functional currency of a subsidiary which was acquired in 2003 (see also note 2a) is its local currency. The financial statements of this subsidiary are included in consolidation based on translation into dollars in accordance with Statement of Financial Accounting Standard (“FAS”) 52 of 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 include 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 associated companies

An “associated company” is a company over which significant influence is exercised, but which is not a consolidated subsidiary. Associated companies are 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. Other investments

These non-marketable investments are carried at cost, net of write down for decrease in value, which is not of a temporary nature - in 2003 amounting \$634 thousands (included in other income-net).

g. Property, plant and equipment

Property, plant and equipment are stated at cost, net of related investment grants (\$ 49.2 million and \$ 49.8 million at December 31, 2003 and 2002, 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	10%-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.

h. Goodwill

On January 1, 2002, the Company adopted FAS No. 142, "Goodwill and Other Intangible Assets ". Pursuant to FAS 142 goodwill is no longer amortized but rather tested for impairment at least annually.

Prior to January 1, 2002, the Group amortized goodwill in equal annual installments, mainly over 40 years.

The Company identified and allocated the goodwill to its various reporting units. The Company has performed a transitional impairment review to determine the fair value of its reporting units and whether any impairment of goodwill existed as of the date of adoption of FAS 142. The transitional impairment review performed by the Company in 2002 did not result in an impairment.

The Company has selected September 30 of each year as the date on which it will perform its annual goodwill impairment review. No impairment resulted from the annual review performed in the year ended December 31, 2003 and 2002.

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):

i. 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 \$ 250 thousands, \$ 164 thousands and \$ 128 thousands, for the years ended December 31, 2003, 2002 and 2001, respectively.

j. Impairment in value of long-lived assets

On January 1, 2002 the Company adopted FAS 144 “Accounting for the Impairment or Disposal of Long- Lived Assets” (“FAS 144”). FAS 144 requires that long-lived assets, to be held and used by an entity be reviewed 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.

The adoption of FAS 144, in 2002 did not have any material effect on the consolidated financial position and results of operations.

k. 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, accordingly, upon distribution of dividends by this subsidiary to the Company, such dividends may be subject to tax. In light of the Group’s policy not to cause distribution of dividends, which would result in additional tax liabilities, any dividends received from the abovementioned subsidiary will be distributed to the Company’s shareholders. Accordingly, no account has been taken of the additional tax in respect of the above dividends.

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

l. Treasury shares

Treasury shares held by the Company are presented as a reduction of shareholders’ equity, at their cost.

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):

m. Revenue recognition:

1) Sale of products

Income from sale of products is generally recognized when title passes to customers.

2) Revenue from hotel services

This income was recognized - in 2001 - as the service was rendered (see also note 3b).

n. Concentration of credit risks - allowance for doubtful accounts

The Group's cash and cash equivalents as of December 31, 2003 and 2002 were deposited mainly with major banks in 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 16b). The balance receivables from these principal customers as of December 31, 2003 and 2002 were \$ 51,297, thousands and \$ 48,271 thousands, respectively (see also note 13a). 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. Certain trade receivables are insured under foreign trade risk insurance. 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, 2003, 2002 and 2001 aggregated \$ 309 thousands, \$ (3,558) thousands and \$ (3,181) thousands, respectively.

o. 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, 2003, 2002 and 2001 were approximately \$ 17 million, \$ 18 million and \$ 15 million, respectively.

p. Advertising costs

These costs are expensed as incurred. Advertising costs for the years ended December 31, 2003, 2002 and 2001 were \$ 1.9 million, \$ 2.5 million and \$ 2.2 million a year, respectively.

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):****q. 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 charged on the date of grant to shareholders’ equity under “deferred compensation”, and thereafter 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.

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		
	2003	2002	2001
	\$ in thousands		
	(except per share data)		
Net income, as reported	\$ 23,352	\$ 16,626	\$ 11,424
Add – stock-based employee compensation expense included in reported net income, net of related tax effect			14
Less – stock-based employee compensation expense determined under fair value method, net of related tax effect	(1,384)	(1,359)	(2,099)
Pro forma net income	<u>\$ 21,968</u>	<u>\$ 15,267</u>	<u>\$ 9,339</u>
Earnings per share:			
Basic – as reported	\$ 1.28	\$ 0.88	\$ 0.60
Basic – pro forma	\$ 1.20	\$ 0.81	\$ 0.49
Diluted – as reported	\$ 1.24	\$ 0.88	\$ 0.60
Diluted – pro forma	\$ 1.17	\$ 0.81	\$ 0.49

DELTA GALIL INDUSTRIES LTD.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):

r. 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.

s. 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.

The Company has adopted FAS No. 133 “Accounting for Derivative Instruments and Hedging Activities”. Under FAS 133, 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.

t. Comprehensive income

In addition to net income, other comprehensive income (loss) includes gains or losses in respect of derivative instruments designated a cash-flow hedge, net of deferred tax, differences from translation of foreign currency financial statements of a subsidiary and additional minimum pension liability adjustments, net of related tax.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued):

u. Consolidation of Variable Interest Entities

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). Under FIN 46, entities are separated into two populations: (1) those for which voting interests are used to determine consolidation (this is the most common situation) and (2) those for which variable interests are used to determine consolidation. FIN 46 explains how to identify Variable Interest Entities (VIEs) and how to determine when a business enterprise should include the assets, liabilities, noncontrolling interests, and results of activities of a VIE in its consolidated financial statements. Since issuing FIN 46, the FASB has proposed various amendments to the Interpretation and has deferred its effective dates. Most recently, in December 2003, the FASB issued a revised version of FIN 46 (FIN 46-R), which also provides for a partial deferral of FIN 46. This partial deferral established the effective dates for public entities to apply FIN 46 and FIN 46-R based on the nature of the variable interest entity and the date upon which the public company became involved with the variable interest entity. In general, the deferral provides that (i) for variable interest entities created before February 1, 2003, a public entity must apply FIN 46-R at the end of the first interim or annual period ending after March 15, 2004, and may be required to apply FIN 46 at the end of the first interim or annual period ending after December 15, 2003, if the variable interest entity is a special purpose entity, and (ii) for variable interest entities created after January 31, 2003, a public company must apply FIN 46 at the end of the first interim or annual period ending after December 15, 2003, as previously required, and then apply FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

The Company has currently no variable interests in any VIE. Accordingly, the Company believes that the adoption of FIN 46 and FIN 46-R will not have material impact on its financial position, results of operations and cash flows.

v. Recently issued accounting pronouncements:

In December 2003, the FASB issued FAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88 and 106, and a revision of FASB Statement No. 132 ("FAS 132 (revised 2003)") ". This Statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans. The new rules require additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. Part of the new disclosures provisions are effective for 2003 calendar year-end financial statements, and accordingly have been applied by the Company in these consolidated financial statements. The rest of the provisions of this Statement, which have a later effective date, are currently being evaluated by the Company.

w. Reclassifications

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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. The results of operations of the acquired business are included in the consolidated financial statements as of the date of acquisition.

a. Acquisition of Auburn Hosiery Mills (“Auburn”)

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 hosiery. The functional currency of the Irish operation is its local currency - the Euro.

The Group paid \$10.8 million in cash to the seller and 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):**

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 - \$ 1.4 million - was allocated to goodwill. Goodwill is not deductible for tax purposes.

At November 13, 2003 (in thousands)

Cash and cash equivalent	\$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	6,163
Net assets acquired	<u>\$10,800</u>

Hereafter are the unaudited pro forma combined condensed income statements for the years ended December 31, 2003 and 2002, assuming that the acquisition had occurred on January 1, 2003 and 2002, respectively. The pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisition taken place at the beginning of 2003 and 2002, nor is it necessarily indicative of future results.

	Year ended December 31	
	2003	2002
	In thousands	
	(except earnings per share)	
	(Unaudited)	
Net Revenues	\$628,017	\$626,732
Net Income	\$19,820	\$16,079
Earning per share – Basic	\$1.08	\$0.85
Earning per share – Diluted	\$1.06	\$0.85

DELTA GALIL INDUSTRIES LTD..

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):

b. Acquisition of the operations of Komar Textile Trading Co. Ltd. (“Komar”)

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. Goodwill is not deductible for tax purposes.

c. Acquisition of Inner Secrets Inc. (“Inner”)

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.

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. The acquisition price was paid as follows: 85% in cash and 15% in Company shares.

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.

The excess of cost of acquisition over the fair value of net assets on acquisition date - \$ 24.3 million - was allocated to goodwill.

At the end of 2002 the Company recorded an additional \$ 2.0 million as an adjustment to the purchase price. The amount was paid in April 2003. The payment was allocated to goodwill.

In addition, under the agreement the Company recorded an additional amount of \$ 6.7 million, payable in 2004, as a final performance payment, which was allocated to goodwill.

Goodwill is not deductible for tax purposes.

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

NOTE 2 – ACQUISITIONS AND OTHER TRANSACTIONS (continued):

OTHER TRANSACTIONS:

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.

NOTE 3 – INVESTMENTS IN STANDARD TEXTILE EUROPE LTD. AND IN EDOMIT LTD.

a. Sale of investment in Standard Textile Europe Ltd. (“STE”)

On August 4, 2000, a subsidiary signed an agreement for the sale of its investment in STE, which was an associated company, for \$ 9 million, which bears interest of LIBOR plus 1.5% per year. Prior to the transaction, the subsidiary held 15% of STE's shares.

The transaction is carried out in four batches, subject to adjustments based on STE's profits, as stipulated in the agreement. The first, second and third batches (approximately 75% of the shares held by the subsidiary) were transferred to the buyer upon the signing of the agreement, in January 2002 and in January 2003, respectively, for a total consideration of \$ 7,300 thousands. The capital gain from the first, second and third batches, totaled to \$780 thousands, \$960 thousands and \$888 thousands, respectively, and was classified to “Other Income – net”. The forth batch (approximately 25% of the shares held by the subsidiary) was transferred to the buyer on January 2004, for a consideration of \$2,640 thousands. The capital gain from the selling of the forth batch amounted to \$ 958 thousands.

As of January 2003 the subsidiary no longer has significant influence on STE, and the investment in STE is presented at cost, which is the balance of the investment as of January 2003.

The balance of the investment in STE as of December 31, 2003 and 2002 is \$1,682 thousands and \$3,364 thousands, respectively.

DELTA GALIL INDUSTRIES LTD..

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 3 – INVESTMENT IN STANDARD TEXTILE EUROPE LTD. AND IN EDOMIT LTD.**

(Continued):

b. Edomit Ltd. (“Edomit”)

The Company holds 50% of the shares in Edomit. As of January 1, 2002, according to a new agreement signed between the Company and the other shareholder, the Company no longer controls Edomit. Accordingly, as of the date of the agreement, the assets and liabilities of Edomit and the results of its operations are no longer included in the consolidated financial statements and the Company's investment in Edomit is accounted for by the equity method.

The balance of the investment in Edomit as of December 31, 2003 and 2002 is \$ 661 thousands and \$ 843 thousands, respectively. As of December 31, 2003 and 2002 these balances include a loan in the amount of \$ 417 and \$ 299, respectively. The loan is linked to the 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:

	December 31	
	2003	2002
	In thousands	
First year – current maturities	\$512	\$553
Second year	362	195
Third year	36	155
Fourth year	21	
	\$419	\$350
	\$931	\$903

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:

	December 31	
	2003	2002
	In thousands	
Land, buildings and plumbing, see b. below*	\$39,877	\$36,648
Machinery and equipment	152,448	153,859
Vehicles, office furniture and equipment and leasehold improvements	52,567	44,244
	244,892	234,751
Less – accumulated depreciation and amortization	(120,015)	(113,150)
	<u>\$124,877</u>	<u>\$121,601</u>
* Including building leased under capital lease - (see note 1g):		
Cost	\$1,414	\$1,414
Less – accumulated depreciation	315	260
	<u>\$1,099</u>	<u>\$1,154</u>

In 2003 the Group recorded a \$ 3.5 million capital gain from sale of real estate in London.

DELTA GALIL INDUSTRIES LTD.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 5 – PROPERTY, PLANT AND EQUIPMENT:****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, 2003 aggregates \$ 22.1 million.
- d. Depreciation and amortization in respect of property, plant and equipment totaled \$14.3 million in the year ended December 31, 2003 and \$ 13.9 million in the years ended December 31, 2002 and 2001 (excluding impairment of assets relating to restructuring, see note 13g).
- e. As to pledges on assets, see notes 8c and 11a.

NOTE 6 – GOODWILL:

- a) Changes in goodwill during the year:

	Year ended December 31, 2003					
	In thousands					
	US Mass market	US Upper market	Europe	Socks	Other	Total
Goodwill at beginning of year	\$ 40,032	\$ 1,000	\$ 753	\$ 3,386	\$1,119	\$ 46,290
Changes during the year:						
Goodwill arising from acquisition of subsidiaries, see note 2a				1,368		1,368
Adjustment to purchase price, see note 2c	6,700					6,700
Translation differences				*		*
Goodwill at end of year	<u>\$ 46,732</u>	<u>\$ 1,000</u>	<u>\$ 753</u>	<u>\$ 4,754</u>	<u>\$1,119</u>	<u>\$54,358</u>

* Less than \$1 thousand.

DELTA GALIL INDUSTRIES LTD.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – GOODWILL (continued):

Year ended December 31, 2002						
In thousands						
	US Mass market	US Upper market	Europe	Socks	Other	Total
Goodwill at beginning of year	\$ 38,029	\$ 1,000		\$ 3,386	\$ 1,119	\$ 43,534
Changes during the year:						
Goodwill arising from acquisition of operations, see note 2b			753			753
Adjustment to purchase price, see note 2c	2,003					2,003
Goodwill at end of year	<u>\$ 40,032</u>	<u>\$ 1,000</u>	<u>\$ 753</u>	<u>\$ 3,386</u>	<u>\$ 1,119</u>	<u>\$ 46,290</u>

- b) The following table illustrates the Group's results, adjusted to eliminate the effect of goodwill amortization expense for the following years:

Year ended December 31			
	2003	2002	2001
	\$ in thousands (except per share data)		
Net income, as reported	\$23,352	\$16,626	\$11,424
Add:			
Goodwill amortization			1,505
Equity method goodwill amortization			120
Adjusted net income	<u>\$23,352</u>	<u>\$16,626</u>	<u>\$13,049</u>
Earnings per share:			
Basic – as reported	\$1.28	\$0.88	\$0.60
Goodwill amortization			\$0.07
Equity method goodwill amortization			\$0.01
Basic – adjusted	<u>\$1.28</u>	<u>\$0.88</u>	<u>\$0.68</u>
Diluted – as reported	\$1.24	\$0.88	\$0.60
Goodwill amortization			\$0.07
Equity method goodwill amortization			\$0.01
Diluted – adjusted	<u>\$1.24</u>	<u>\$0.88</u>	<u>\$0.68</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:

	December 31	
	2003	2002
	In thousands	
Accrued severance pay	\$5,442	\$4,996
Obligation in respect of defined benefit plans	1,290	1,363
	<u>\$6,732</u>	<u>\$6,359</u>

As of December 31, 2003 and 2002, the Group had deposits of \$ 5.1 million and \$ 4.0 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”.

The total contribution expected to be paid by the Group for Israeli funds plans during 2004 is approximately \$1.0 million.

Costs of pension and severance pay charged to income in the years ended December 31, 2003, 2002 and 2001 were \$ 7.0 million, \$ 6.5 million and \$ 5.9 million respectively (in 2003, 2002 and 2001, excluding \$ 813 thousands, \$ 651 thousands and \$ 806 thousands, respectively, relating to the termination of employment, which were charged to restructuring expenses, see note 13g.

The loss from deposits in respect of severance pay were \$ 214 thousands, \$ 624 thousands and \$ 180 thousands in the years ended December 31, 2003, 2002 and 2001, 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 c. below.

DELTA GALIL INDUSTRIES LTD.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 – EMPLOYEE RIGHTS UPON RETIREMENT (continued):

b. Terms of arrangements:

1) The Company and Israeli subsidiaries

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

- 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.
- 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, 2003, 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 25% of each participant's pretax contribution up to 4% of the participant's annual compensation.

DELTA GALIL INDUSTRIES LTD.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 – EMPLOYEE RIGHTS UPON RETIREMENT (continued):

c. Certain details relating to defined benefit plans:

	2003	2002	
	In thousands		
Change in benefit obligation:			
Benefit obligation at beginning of year	\$3,150	\$2,837	
Interest cost	183	190	
Actuarial loss	7	312	
Benefit paid	(195)	(189)	
Benefit obligation at end of year	\$3,145	\$3,150	
Change in plan assets:			
Fair value of plan assets at beginning of year	\$2,931	\$2,843	
Actual return on plan assets	152	168	
Employer contribution		99	
Benefit paid, including plan expenses	(195)	(189)	
Fair value of plan assets at end of year	\$2,888	\$2,921	
Reconciliation of funded status:			
Funded status (carryforward obligations)	\$(257)	\$(229)	
Unrecognized net actuarial loss	1,290	1,363	
Adjustment to recognize minimum liability	(1,290)	(1,363)	
Prepaid / pension cost (accrued)	\$(257)	\$(229)	
	2003	2002	2001
Weighted average assumptions at end of year:			
Discount rate	6.00%	6.25%	7.00%
Expected return on plan assets	6.25%	6.50%	7.75%
Rate of compensation increase	N/A	N/A	N/A

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

	Year ended December 31		
	2003	2002	2001
	In thousands		
Interest cost	\$183	\$ 190	\$83
Actual return on plan assets	(152)	(134)	(75)
Net amortization	80	57	23
	<u>\$111</u>	<u>\$113</u>	<u>\$31</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 – LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY:

a. Composition:

	Weighted average interest rate*	December 31	
	December 31,	2003	2002
	%	In thousands	
Bank loans - in dollars or linked thereto	2.5	\$18,857	\$28,286
Bank loans - in Canadian dollars	2.9	5,191	4,996
Other liability -			
Obligation under capital lease, see note 1g			
and c. below - in dollars	8.6	1,097	1,155
		25,145	34,437
L e s s - current maturities		10,436	10,257
		<u>\$14,709</u>	<u>\$24,180</u>

* Some of the loans bear interest at variable rates (mainly on a Libor + 1.2%).

- b.** Total liabilities (net of current maturities) mature in the following years after balance sheet dates:

	December 31	
	2003	2002
	In thousands	
Second year	\$10,440	\$10,261
Third year	1,018	10,266
Fourth year	1,024	844
Fifth year	1,031	850
Sixth year and thereafter	1,196	1,959
	<u>\$14,709</u>	<u>\$24,180</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 8 – LONG-TERM LIABILITIES - BANK LOANS AND OTHER LIABILITY (continued):**

- c. A subsidiary of the Company has entered into operating 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, 2003:

	<u>In thousands</u>
First year – current maturities	\$ 158
Second year	158
Third year	158
Fourth year	158
Fifth year	158
Sixth year and thereafter	<u>950</u>
	1,740
L e s s – amount representing interest	<u>643</u>
	<u><u>\$ 1,097</u></u>

- 1) 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.
- 2) A subsidiary is a party to a credit agreement, which was amended, as of June 14, 2003, 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 \$ 86 million in loans, of which \$ 26 million are long term loans and the remainder is short term credit. The principal of the term loans is payable in 14 equal quarterly installments of approximately \$1.9 million each until December 1, 2005. As of December 31, 2003 the utilized credit line was \$ 31.4 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 27 facilities under operating leases. The leases (including extension options) for 20 facilities expire on various dates between 2005 and 2025 and the remaining leases expired in 2004. The Company intends to renew some of these leases. The minimum future annual lease payment over each of the years 2004 to 2008 will amount to \$ 5.5 million. In the period from 2009 to the end of the lease periods, the cumulative lease payments will amount to \$ 13.7 million. The lease expenses for each of the years 2003, 2002 and 2001 were \$ 7.2 million, \$ 6.6 million and \$ 7.3 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.

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, 2003, the closing price per ADS on Nasdaq was \$ 15.75; the shares were quoted on the TASE on that date at NIS 69.7 (\$ 15.9).
- 2) 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).
- 3) 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.
- 4) Pursuant to a purchase agreement dated January 5, 2001 (see note 2c), the Company issued 454,020 ordinary shares of NIS 1 par value.
- 5) As of December 31, 2003 and 2002, 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 87,638 and 100,447 shares, respectively.
- 6) The shares held by the Company have no voting rights and are not entitled to receive dividends.

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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, 2002, 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, 2003, 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 in purchase of 809,000 ordinary shares of NIS 1 par value of the Company, to 70 senior employees of the Group ("the optionees"). All the options were granted on August 6, 2000. The exercise price of each option is \$ 21.07, based on the quoted price of the Company's shares on the last day of trade prior to the Board of Directors' resolution.

The options vest in four equal batches: the first, second, third and fourth batches 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 10 – SHAREHOLDERS' EQUITY (continued):

On 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-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, 2003 122,000 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					
	2003		2002		2001	
	Number*	Weighted average exercise price**	Number*	Weighted average exercise price**	Number*	Weighted average exercise price**
Options outstanding at beginning of year	2,038,562	\$ 13.07	1,076,940	\$ 17.10	1,156,642	\$ 17.29
Changes during the year:						
Granted	30,000	\$ 10.76	1,004,500	\$ 9.00		
Exercised	(180,109)	\$ 7.91	(2,003)	\$ 8.30	(8,077)	\$ 8.30
Forfeited	(57,751)	\$ 11.35	(40,875)	\$ 18.11	(71,625)	\$ 21.07
Options outstanding at end of year	1,830,702	\$ 13.50	2,038,562	\$ 13.07	1,076,940	\$ 17.10
Options exercisable at end of year	528,952	\$ 17.15	405,880	\$ 16.94	534,315	\$ 11.76

* Represents the number of shares arising upon exercise of options, based on the conversion ratio.

** Per option.

- 8) The fair value of options granted during 2003 and 2002 was \$ 35 thousands and \$ 1.7 million, 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:

	2003	2002
Dividend yield	5%	5%
Expected volatility	27.33%	30.94%
Risk-free interest rate	1%	2%
Expected life – in years	4.58	5.58

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 10 – SHAREHOLDERS' EQUITY (continued):**

- 9) The following table summarizes information regarding options outstanding at December 31, 2003:

Number of shares issuable upon exercise of options				
Outstanding			Vested	Exercisable
Exercise prices	Balance at December 31, 2003	Weighted average remaining contractual life	Balance at December 31, 2003	Balance at December 31, 2003
		Years		
\$8.30	107,452	1.8	107,452	107,452
\$7.90	50,000	2.4	50,000	50,000
\$21.07	690,250	3.0	532,125	371,500
\$9.00	953,000	4.7	238,250	
\$10.76	30,000	5.1		
	<u>1,830,702</u>		<u>927,827</u>	<u>528,952</u>

c. Retained Earnings

- 1) 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.
- 2) Dividends are declared and paid in dollars. On March 2004, the Company declared the distribution of a dividend of approximately \$ 2.2 million, payable to shareholders of record on March 21, 2004 (\$ 0.12 per share).

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.

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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.

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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 a certain subsidiary 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 this subsidiary 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 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.

DELTA GALIL INDUSTRIES LTD..

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 11 – TAXES ON INCOME (continued):**

- 4) Tax rates in Israel applicable to income not derived from approved enterprises

Income not eligible for the approved enterprise benefits mentioned in (1) above is taxed at the regular rate of 36%.

b. Non-Israeli subsidiaries

Non-Israeli subsidiaries are taxed according to the tax laws in their country of residence.

c. Carryforward tax losses

Carryforward tax losses as of December 31, 2003 and 2002, aggregate \$ 33 million and \$ 22 million, respectively.

Carryforward tax losses and “real” losses in Israel may be utilized indefinitely.

d. Deferred income taxes:

- 1) The deferred income taxes are composed as follows:

	December 31	
	2003	2002
	In thousands	
Property, plant and equipment	\$13,975	\$13,945
Inventories	(907)	(1,242)
Provisions for employee related obligations	(1,551)	(1,242)
Other	(321)	1,005
In respect of carryforward tax losses (see c. above)	(10,360)	(7,151)
Total	<u>\$836</u>	<u>\$5,315</u>

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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:

	December 31	
	2003	2002
	In thousands	
Current asset	\$(5,464)	\$(8,311)
Long-term asset		(745)
Long term liability	6,300	14,371
	<u>\$836</u>	<u>\$5,315</u>

e. **Income before income taxes is composed as follows:**

	Year ended December 31		
	2003	2002	2001
	In thousands		
The Company and its Israeli Subsidiaries	\$(4,832)	\$(8,658)	\$(1,446)
Non-Israeli subsidiaries	36,263	31,930	19,365
	<u>\$31,431</u>	<u>\$23,272</u>	<u>\$17,919</u>

f. **Taxes on income included in the statements of income:**

	Year ended December 31		
	2003	2002	2001
	In thousands		
Current:			
Israeli	\$746	\$353	\$191
Non-Israeli	10,292	4,963	4,015
	<u>11,038</u>	<u>5,316</u>	<u>4,206</u>
Deferred:			
Israeli	\$(4,075)	\$(1,796)	\$881
Non-Israeli	520	2,236	749
	<u>(3,555)</u>	<u>440</u>	<u>1,630</u>
For previous years :			
Israeli	\$(30)	\$(112)	\$69
Non-Israeli	(113)	135	(29)
	<u>(143)</u>	<u>23</u>	<u>40</u>
	<u>\$7,340</u>	<u>\$5,779</u>	<u>\$5,876</u>

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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%) and the actual tax expense:

	Year ended December 31		
	2003	2002	2001
	In thousands		
Income before taxes on income, as reported in the consolidated statements of income	\$31,431	\$23,272	\$17,919
Theoretical tax expense	\$11,315	\$8,378	\$6,450
Additional tax expenses arising from reduced tax rate on losses from an approved enterprise	380	958	68
Decrease in tax arising from different tax rate applicable to non-Israeli subsidiaries	(2,834)	(3,886)	(2,029)
	8,861	5,450	4,489
Increase in taxes resulting from recomputation the deferred taxes due to the change in the basis of adjustment – from the changes in the Israeli CPI to the changes in exchange rate of the dollar, see a(2) above.			2,126
Increase (decrease) in taxes resulting from permanent differences:			
Disallowable deductions	36	22	432
Sundry – net	(1,557)	307	(1,171)
Taxes on income – in the consolidated statements of income	\$7,340	\$5,779	\$5,876

h. Tax assessments

Tax assessments for the Company and most of its subsidiaries are final through the tax year 1999.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – MONETARY BALANCES IN NON-DOLLAR CURRENCIES:

a. As follows:

	December 31, 2003		
	Israeli currency	Pound sterling	Other non- dollar currencies
	In thousands		
Assets :			
Current assets	\$16,120	\$23,733	\$10,982
Long-term receivables (including current maturities)	\$419		
Liabilities:			
Current liabilities	\$32,727	\$15,226	\$18,961
Long-term liabilities – long-term loan (including current maturities)			\$5,191

The above balances do not include Israeli currency balances linked to the dollar. The Company establishes the currency of the short-term bank credit with the purpose of minimizing currency exposure of monetary assets.

b. Data regarding changes in exchange rates and the Israeli CPI:

	Year ended December 31		
	2003	2002	2001
Increase (decrease) in the exchange rate of Israeli currency in relation to:			
The dollar	(7.6%)	7.3%	9.3%
The pound sterling	2.8%	19.3%	6.1%
Rate of (decrease) increase in the Israeli CPI	(1.9%)	6.5%	1.4%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION:

Balance sheets:

	December 31	
	2003	2002
	In thousands	
a. Accounts receivable:		
1) Trade:		
Outside Israel	\$73,728	\$85,315
In Israel	11,995	10,286
	<u>\$85,723</u>	<u>\$95,601</u>
Allowance for doubtful accounts:		
Opening balance	\$1,131	\$3,671
K-mart		
Hamashbir		859
Other		95
Decrease due to bad debts		
K-mart		(3,494)
Other	(123)	
Increase due to an acquisition of a new subsidiary	30	
Closing balance	<u>\$1,038</u>	<u>\$1,131</u>
Principal customers (see note 1n and 16b):		
Customer 1	<u>\$18,890</u>	<u>\$18,916</u>
Customer 2	<u>\$16,500</u>	<u>\$14,601</u>
Customer 3	<u>\$15,907</u>	<u>\$14,754</u>
2) Other:		
Investment grant receivable	\$576	\$900
Government departments – mainly value added tax refundable	4,500	3,125
Prepaid expenses	2,046	1,539
Deposits	663	521
Income receivable	96	353
Employees	512	553
Receivables from subcontractors	1,157	1,221
Sundry	1,112	1,102
	<u>\$10,662</u>	<u>\$9,314</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

	December 31	
	2003	2002
	In thousands	
b. Inventories:		
Finished products	\$94,338	\$86,306
Products in process	21,380	21,305
Raw materials and supplies	19,918	20,274
Packaging and maintenance materials	7,348	5,478
	<u>\$142,984</u>	<u>\$ 133,363</u>

c. Short-term bank credit

The weighted average interest rate of short-term bank credit as of December 31, 2003 is 1.9%.

A subsidiary is a party to a credit agreement, which was amended, as of June 14, 2003, 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.

Unutilized short-term credit lines of the Group as of December 31, 2003 and 2002 aggregated to \$ 54.6 million and \$ 56 million, respectively.

	December 31	
	2003	2002
	In thousands	
d. Accounts payable and accruals - other:		
Employees and employee institutions	\$10,339	\$6,474
Provision for vacation and recreation pay	4,463	4,359
Income tax payable	1,612	525
Accrued expenses	12,442	11,185
Accrued expenses – restructuring costs	6,163	
In respect of shares purchase, see note 2c	6,700	2,003
In respect of derivatives, see note 14b	2,657	718
Other	3,766	1,095
	<u>\$48,142</u>	<u>\$26,359</u>

Statements of income:

	2003	2002	2001
	In thousands		
e. Net revenues - classified by type:			
Revenues from textile products	\$580,130	\$ 567,298	\$ 555,655
Revenues from hotel services*			3,108
	<u>\$580,130</u>	<u>\$ 567,298</u>	<u>\$ 558,763</u>

* See note 3b.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):

	<u>2003</u>	<u>2002</u>	<u>2001</u>
	<u>In thousands</u>		
f. Cost of revenues – classified by type:			
Cost of textile products	\$466,378	\$456,738	\$452,948
Cost of hotel services*			2,778
	<u>\$466,378</u>	<u>\$456,738</u>	<u>\$455,726</u>

* See note 3b

g. Restructuring expenses

During 2003, 2002 and 2001, the Group ceased the operations of some of its facilities under three different restructuring plans. As a result, the Group's workforce was reduced by approximately 219, 899 and 257 employees, respectively. The Group's restructuring expenses in 2003, 2002 and 2001 - \$ 1,007 thousands, \$1,065 thousands and \$900 thousands, respectively, consist of approximately - \$813 thousands, \$651 thousands and \$806 thousands, respectively, employees' severance and related costs and \$194 thousands, \$ 414 thousands and \$ 94 thousands in respect of impairment of assets, respectively.

h. Financial expenses – net:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
	<u>In thousands</u>		
Interest expenses	\$4,749	\$4,286	\$7,171
Interest income	(281)	(92)	(13)
Exchange differences and other – net	557	939	(2,326)
loss (gain) from derivatives instruments	612	323	(81)
	<u>\$5,637</u>	<u>\$5,456</u>	<u>\$4,751</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 13 – SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION (continued):****i. Earnings per share**

Following is data relating to the weighted average number of shares used in the computation of diluted earnings per share:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
	<u>In thousands</u>		
Weighted average number of shares used in the computation of basic earnings per share	18,313	18,914	19,175
Add:			
Net additional shares from the anticipated exercise of stock options	<u>450</u>	<u>13</u>	<u>24</u>
Weighted average number of shares used in the computation of diluted earnings per share	<u>18,763</u>	<u>18,927</u>	<u>19,199</u>

NOTE 14 – 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 14 – 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, 2001 (the date of adoption of FAS 133) through December 31, 2003:

	2003	2002	2001
	\$ In thousands		
Balance at beginning of year	\$(583)	\$225	
Changes in fair value of derivatives – loss	(2,905)	(2,114)	(215)
Reclassification into earnings from other comprehensive income (loss)	1,297	943	541
Net of tax effect	474	363	(101)
Balance at end of year	<u>\$(1,717)</u>	<u>\$(583)</u>	<u>\$225</u>

Hedge ineffectiveness had impact on earnings for 2003 of \$ 0.5 million loss and had no material impact on earnings for the years ended December 31, 2002 and 2001. No cash flow hedges were discontinued during the years ended December 31, 2003 and 2002. The Company estimates that net derivative losses (before tax) of approximately \$2,450 thousands included in accumulated other comprehensive income at December 31, 2003 will be reclassified into earnings during the next six months.

As of December 31, 2003, the Company had entered into hedging transactions for the exchange of \$ 30 million into pounds sterling at an average rate of \$ 1.64 per pound sterling. These transactions will be released into earnings during 2004.

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 and 2002 are \$ 2,657 thousands and \$ 718 thousands, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**NOTE 15 – “RELATED PARTIES” – TRANSACTIONS AND BALANCES:****a. Transactions with related parties:**

	Year ended December 31		
	2003	2002	2001
	In thousands		
Net revenues from textile products	\$2,433	\$4,922	\$10,305
Purchases and other expenses	\$249	\$410	\$416

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:

	December 31	
	2003	2002
	In thousands	
Current receivables – presented in the balance sheets among “accounts receivable – trade”	\$251	\$1,124
Current liabilities – presented under “accounts payable and accruals”	\$28	\$106

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 16 – SEGMENT INFORMATION :

a. Information on operating segments:

Operating segments:

1) General:

As of 2002, the Company conducts its worldwide operations in four operating segments as follows:

- U.S mass market, 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.

Other operations include wholesale and retail operations in the Israeli market and the textile infrastructure operations which comprised manufacturing of fabric, elastic tapes and seam free products.

Segments information for the year 2001 is not provided since it is impracticable to do so due to the fact that during 2002, the Company's management decided to make changes to the structure of the internal divisions' in order to enhance customer relationships and to improve the services provided to various customers at both a qualitative and procedural level.

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 16 – SEGMENT INFORMATION (continued):

b) Financial data relating to reportable operating segments:

	<u>US Mass market</u>	<u>US Upper market</u>	<u>Europe</u>	<u>Socks</u>	<u>Other</u>	<u>Adjustments</u>	<u>Total</u>
	(U.S. \$ In thousands)						
Year ended December 31, 2003:							
Net revenues:							
To unaffiliated customers	\$218,959	\$57,927	\$176,827	\$91,044	\$36,673	\$(1,300) (1)	\$580,130
Intersegment		8,587	563	759	32,726	(42,635)	- ;-
Total net revenues	<u>\$218,959</u>	<u>\$66,514</u>	<u>\$177,390</u>	<u>\$91,803</u>	<u>\$69,399</u>	<u>\$(43,935)</u>	<u>\$580,130</u>
Operating income (loss)	<u>\$24,780</u>	<u>\$(1,694)</u>	<u>\$4,453 (4)</u>	<u>\$9,322</u>	<u>\$(5,081)</u>	<u>\$5,036 (2)</u>	<u>\$36,816</u>
Assets (at end of year)	<u>\$137,548</u>	<u>\$33,486</u>	<u>\$109,035</u>	<u>\$76,003</u>	<u>\$60,797</u>	<u>\$34,015 (3)</u>	<u>\$450,884</u>
Depreciation and amortization	<u>\$1,477</u>	<u>\$2,000</u>	<u>\$4,359</u>	<u>\$2,464</u>	<u>\$3,589</u>	<u>\$641</u>	<u>\$14,530</u>

(1) Results of hedge transactions

(2) Including mainly capital gain in an amount of \$ 3,645 thousands, the effect of hedge transactions in an amount of \$ 1,300 thousands and \$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 costs in the amount of \$ 1,007 thousands in Europe.

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 16 – SEGMENT INFORMATION (continued):

	<u>US Mass market</u>	<u>US Upper market</u>	<u>Europe</u>	<u>Socks</u>	<u>Other</u>	<u>Adjustments</u>	<u>Total</u>
	(U.S. \$ In thousands)						
Year ended December 31, 2002:							
Net revenues:							
To unaffiliated customers	\$202,024	\$78,875	\$170,265	\$83,601	\$33,493	\$(960)(1)	\$567,298
Intersegment		5,900	706	1,651	42,823	(51,080)	- ;-
Total net revenues	<u>\$202,024</u>	<u>\$84,775</u>	<u>\$170,971</u>	<u>\$85,252</u>	<u>\$76,316</u>	<u>\$(52,040)</u>	<u>\$567,298</u>
Operating income (loss) (3)	<u>\$14,575</u>	<u>\$(1,625)</u>	<u>\$10,205</u>	<u>\$8,145</u>	<u>\$(5,092)</u>	<u>\$1,560(4)</u>	<u>\$27,768</u>
Assets (at end of year)	<u>\$143,443</u>	<u>\$45,763</u>	<u>\$105,402</u>	<u>\$52,579</u>	<u>\$58,009</u>	<u>\$35,862 (2)</u>	<u>\$441,058</u>
Depreciation and amortization	<u>\$1,215</u>	<u>\$1,890</u>	<u>\$3,942</u>	<u>\$2,718</u>	<u>\$3,514</u>	<u>\$803</u>	<u>\$14,082</u>

(1) 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 US Mass Market.

(4) Including mainly the effect of hedge transactions in an amount of \$ 960 thousands and \$ 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 16 – SEGMENT INFORMATION (continued):

b. Geographical information:

	Year ended December 31		
	2003	2002	2001
	In thousands		
1) Revenues from textile products (attributed to geographic area based on the location of the customers):			
North America	\$300,708	\$303,103	\$310,664
United Kingdom	187,885	181,302	156,768
Europe (other than U.K.)	48,766	44,409	45,868
Israel	42,771	38,484	42,355
	<u>\$580,130</u>	<u>\$567,298</u>	<u>\$555,655</u>

- 2) The net balance of the Company's long lived assets, by geographic location, are as follows:

	December 31		
	2003	2002	2001
	In thousands		
Israel	\$60,108	\$64,998	\$68,439
Egypt	22,218	20,940	19,143
Eastern Europe	11,719	6,803	
Jordan	9,666	10,510	11,435
United States	8,369	7,284	5,482
Ireland	5,450		
United Kingdom	4,429	7,740	8,712
Other	2,918	3,326	4,186
	<u>\$124,877</u>	<u>\$121,601</u>	<u>\$117,397</u>

	Year ended December 31		
	2003	2002	2001
	In thousands		
3) Revenues from principal customers:			
Customer 1	<u>\$179,120</u>	<u>\$174,195</u>	<u>\$153,330</u>
Customer 2	<u>\$86,829</u>	<u>\$ 65,317</u>	
Customer 3	<u>\$82,472</u>	<u>\$76,910</u>	<u>\$64,332</u>

DELTA GALIL INDUSTRIES LTD.

(An Israeli corporation)

Schedule I

Allowance for doubtful accounts

	December 31		
	2003	2002	2001
	In thousands		
Allowance for doubtful accounts:			
Opening balance	\$ 1,131	\$ 3,671	\$ 923
K-mart			3,494
Hamashbir		859	
Other		95	
Decrease due to bad debts			
K-mart		(3,494)	(746)
Other	(123)		
Increase due to an acquisition of a new subsidiary	30		
Closing balance	<u>\$ 1,038</u>	<u>\$ 1,131</u>	<u>\$ 3,671</u>

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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 2003 and 31 December 2002 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 2003. 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 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 the significant estimates made by 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 2003 and 31 December 2002 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 2003, 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 2002 and the results of its operations for each of the three years in the period ended 31 December 2002 and the generally accepted accounting principles in the United States of America.

BAKER TILLY

Registered Auditor
Chartered Accountants
2 Bloomsbury Street
London WC1B 3ST

10 May 2004

Ernst&Young Allied for Accounting & Auditing Phone: +20 2 336 2000
37 El Ahrar Street, Mobica Tower Fax: +20 2 760 0818
P.O. Box 97 Dokki, Giza-Egypt cairo.office@eg.ey.com
www.ey.com/eyme

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 December 31, 2003 and 2002 and the related statements of income, changes in shareholder's equity and cash flows for each of the three years in the period ended December 31, 2003. 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 (GAAS) in U.S. 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 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 December 31, 2003 and 2002, 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 December 31, 2003, in conformity with generally accepted accounting principles ("GAAP") in the United States.

Emad H. Ragheb
FFSAA – FEST
(RAA – 3678)

Cairo May 10, 2004

Ernst&Young

Allied for Accounting & Auditing

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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 December 31, 2003 and 2002 and the related statements of income, changes in shareholder's equity and cash flows for each of the three years in the period ended December 31, 2003. 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 (GAAS) in U.S. 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 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 December 31, 2003 and 2002, 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 December 31, 2003, in conformity with generally accepted accounting principles ("GAAP") in the United States.

Emad H. Ragheb**FFSAA – FEST****(RAA – 3678)****Cairo May 10, 2004**

**AGREEMENT
FOR
PURCHASE AND SALE OF STOCK
of
AUBURN HOSIERY MILLS, INC.,
a Kentucky corporation
(the “Company”),**

**by and among
DELTA GALIL USA INC.,
a Delaware corporation
 (“Delta USA”),**

**DELTA GALIL INDUSTRIES, LTD.,
an Israeli corporation
 (“Delta”),**

**DELTA GALIL HOLLAND, B.V.
a Netherlands corporation
 (“Delta Holland”),**

**GCW HOLDINGS, INC.,
a Delaware corporation
 (“Stockholder”)**

**GCI SPAINCO, S.L.,
a Spanish corporation
 (“Spainco”)**

**and
KELLWOOD COMPANY.
a Delaware corporation
 (“Kellwood”)**

October 30, 2003

AGREEMENT
FOR
PURCHASE AND SALE OF STOCK

THIS AGREEMENT (the “**Agreement**”) is made and entered into as of the 30th day of October, 2003, by and among GCW Holdings, Inc., a Delaware corporation (“**Stockholder**”) and the sole stockholder of Auburn Hosiery Mills, Inc., a Kentucky corporation (the “**Company**”), GCI Spainco, S.L., a Spanish corporation (“**Spainco**”) and the sole stockholder of Sport Socks Co.(Ireland), Limited, an Irish corporation (the “**Irish Subsidiary**”), Kellwood Company, a Delaware corporation and the indirect parent corporation of the Stockholder (“**Kellwood**,” and collectively with the Stockholder and Spainco, the “**Sellers**”), Delta Galil USA Inc., a Delaware corporation (“**Delta USA**”), Delta Galil Holland, B.V., a Netherlands corporation (“**Delta Holland**”) and Delta Galil Industries Ltd, an Israeli corporation and the direct parent corporation of Delta USA (“**Delta**,” and collectively with Delta USA, the “**Buyers**”).

WHEREAS, Stockholder is the record and beneficial owner of all of the issued and outstanding capital stock, \$100.00 par value per share, of the Company (the “**Stock**”);

WHEREAS, Spainco is the registered and beneficial owner of all of the issued and outstanding shares of €1.269738 in the capital of the Irish Subsidiary (the “**Irish Stock**”); and the record and beneficial owner of all of the outstanding capital stock of the two (2) subsidiaries listed on Schedule 3.5 (the “**Other Subsidiaries**” and with Spainco and the Irish Subsidiary, collectively, the “**Subsidiaries**”); and

WHEREAS, the Company and Subsidiaries are engaged in the design, development, manufacture, importation, marketing, distribution and sale of hosiery (the “**Business**”);

WHEREAS, Delta USA desires to purchase from Stockholder, and Stockholder desires to sell to Delta USA, the Stock (which will include ownership of the Other Subsidiaries) on the terms and conditions set forth herein;

WHEREAS, Delta Holland desires to purchase from Spainco, and Spainco desires to sell to Delta Holland, the Irish Stock on the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the mutual premises and promises herein contained, the parties agree as set forth below.

ARTICLE I

THE TRANSACTION

1.1. Purchase and Sale of Stock. (a) Subject to the terms and conditions of this Agreement, Spainco hereby agrees to sell, transfer, convey, assign and deliver to Delta Holland, and Delta Holland hereby agrees to purchase, acquire and accept from Spainco, all right, title and interest in and to the Irish Stock, at the Irish Closing on the Irish Closing Date (as defined in Section 2.1 herein), free and clear of any Encumbrance whatsoever. At the Irish Closing,

Spainco shall deliver to Delta Holland certificates representing all of the Irish Stock free and clear of any Encumbrance along with appropriate stock transfer forms duly executed by Spainco. For purposes of this Agreement, “**Encumbrance**” shall mean any lien, mortgage, pledge, claim, security interest, imperfection in title or other third-party right or interest of any kind whatsoever, or restrictive agreement, conditional sales agreement, option, encumbrance or charge of any kind whatsoever.

(b) Subject to the terms and conditions of this Agreement, Stockholder hereby agrees to sell, transfer, convey, assign and deliver to Delta USA, and Delta USA hereby agrees to purchase, acquire and accept from the Stockholder, all right, title and interest in and to the Stock, at the Auburn Closing on the Auburn Closing Date (as defined in Section 2.1 herein), free and clear of any Encumbrance whatsoever. At the Auburn Closing, Stockholder shall deliver to Delta USA certificates representing all of the Stock free and clear of any Encumbrance along with appropriate stock powers duly executed by the Stockholder.

1.2. Purchase Price. (a) Subject to Section 1.3, the aggregate purchase price (the “**Purchase Price**”) for the Stock shall be Seven Million Dollars (\$7,000,000). Except for \$500,000 in cash which shall remain in the Irish Subsidiary on the Irish Closing Date (the “**Remaining Cash**”), all other cash, including all cash collections (subject to Section 5.3 hereof) through the day prior to Auburn Closing, and the life insurance policy listed on Schedule 1.2 shall be transferred to and remain the property of Sellers.

(b) The aggregate purchase price (the “**Irish Purchase Price**”) for the Irish Stock shall be One Hundred Dollars (\$100.00).

1.3. Purchase Price Adjustment. The Purchase Price shall be subject to adjustment as specified in this Section 1.3:

(a) The Purchase Price shall be adjusted upward to the extent of the Remaining Cash plus certain expenses actually paid as set forth on Schedule 1.3 which sets forth the specific nature of such expenses (the “**Shutdown Expenses**”) and amounts actually paid by the Sellers prior to the Closing in connection with the shut down of the operations of the Irish Subsidiary or with the restructuring of the operations of the Company.

(b) The Purchase Price shall be adjusted downward by the purchase price paid (*i.e.*, \$245,000) for certain equipment by Affiliates of Buyers from the Irish Subsidiary pursuant to that certain Equipment Purchase and Sale Agreement dated October 23, 2003. For purposes of this Agreement, “**Affiliate**” shall mean an affiliate of an individual or entity as the term “affiliate” is defined in the rules and regulations promulgated under the Securities Act of 1933, as amended.

(c) Buyers shall be entitled to receive the benefit or credit for any government rebates or credits (“**Credits**”) associated with or related to the discontinuance, restructuring or shut down of the operations of the Company or any Subsidiaries, whether or not Credits are received prior to or after the Closing Date. The Purchase Price shall be adjusted downward for any Credits received by Sellers or received by the Company or Subsidiaries prior to Closing.

1.4 Intercompany Loans and Indebtedness. Any (i) intercompany loans, indebtedness, charges or payables, or (ii) payments related to employee benefits provided to Employees (as hereinafter defined) prior to the Auburn Closing (“**Benefit Payments**”) owed by the Company or any Subsidiary to Kellwood or any of Kellwood’s subsidiaries or Affiliates or any trust shall be forgiven or satisfied prior to the Auburn Closing. Any and all Benefit Payments assessed after the Auburn Closing shall be paid or assumed by Kellwood.

1.5 Section 338(h)(10) Election. The Sellers and Buyers shall jointly make or cause to be made timely and irrevocable elections under Section 338(h)(10) of the Code with respect to the sale of all or any of the Company Stock hereunder and, if permissible, similar elections under any applicable state or local income tax laws (the “**Elections**”). Sellers and Buyers shall report the transactions consistent with such elections under Section 338(h)(10) of the Code or any similar state, local or foreign tax provision and shall take no position contrary thereto unless and to the extent required to do so pursuant to a determination (as defined in Section 1313(a) of the Code or any similar state, local or foreign tax provision).

Buyers shall be responsible for preparing drafts of all forms, attachments and schedules necessary to effectuate the Elections (including, without limitation, Internal Revenue Service Forms 8023 and 8883 and any similar forms under applicable state or local income tax laws) (the “**Section 338 Forms**”). As soon as reasonably practicable following the Auburn Closing Date, and in no event more than one hundred twenty business days thereafter, Buyers shall furnish Sellers with a copy of each such draft Section 338 Forms prepared by Buyers together with a copy of a report (the “**Allocation Report**”) of the proposed allocation pursuant to Article 1.6. Sellers shall have thirty (30) business days to disagree with the Section 338 Forms and Allocation Report prepared by Buyers and, in the event of any such disagreement, the parties shall act in good faith to come to agreement thereon.

Buyers and Sellers agree that none of them shall, or shall permit any of their Affiliates to, take any action to modify the Section 338 Forms following the execution thereof, or to modify or revoke the Elections following the filing of the Section 338 Forms, without the written consent of Buyers and Sellers.

Buyers and the Company shall, and shall cause their respective Affiliates to, file all Tax Returns in a manner consistent with the information contained in the Section 338 Forms filed and the allocation provided pursuant to Section 1.6.

1.6 Allocation of Purchase Price. Sellers and Buyers agree to allocate the price at which the Company is deemed to have sold its assets pursuant to Section 338(h)(10) of the Code and in a manner consistent with the methodology set forth in Schedule 1.6 attached hereto. Any adjustment to the consideration paid pursuant to this Agreement shall result in an appropriate adjustment to such allocation.

ARTICLE II

THE CLOSING AND TRANSFER OF STOCK

2.1 Closing. The consummation of the purchase and sale contemplated by this Agreement except for the sale and transfer of the Irish Stock (the “**Auburn Closing**”) shall occur at the offices of Pryor Cashman Sherman and Flynn LLP, 410 Park Avenue, New York, New York 10022, no later than the fifth (5th) business day following the satisfaction or waiver of all of the conditions to Closing set forth in Articles VII and VIII hereof, or such other time, place and date as may be mutually agreed upon by the parties hereto. The date of the Auburn Closing is sometimes referred to herein as the “**Auburn Closing Date**”. The Auburn Closing shall immediately follow the transfer and sale of the Irish Stock from Spainco to Delta Holland (the “**Irish Closing**”). The date of the Irish Closing is sometimes referred to herein as the “**Irish Closing Date**”, which shall take place at the offices of Pryor Cashman Sherman & Flynn.

2.2 Deliveries by Buyers. Subject to the terms and conditions of this Agreement, in reliance on the representations, warranties and agreements of the Company and Sellers contained in this Agreement, and in consideration of the transfer and sale of the Stock, the Buyers agree to deliver at the Auburn Closing the following, all reasonably satisfactory in form and substance to Sellers (the delivery of which may be waived in writing by Sellers):

- (a) a wire transfer of the Purchase Price as adjusted pursuant to Section 1.3;
- (b) a Certificate of the Secretary of the Buyers as to the resolutions authorizing the transactions contemplated hereby;
- (c) a certificate signed by an officer of the Buyers certifying that the conditions to Auburn Closing described in Article VIII have been fulfilled;
- (d) an executed copy of the letter agreement among Delta, Kellwood and Wilson Sporting Goods Co. (“**Wilson**”) regarding Wilson’s approval of the change in control of Company. This letter agreement shall be completed and executed in a form sufficient to obtain Wilson’s consent to the change in control of the Company and shall be in a form substantially similar to that provided in Exhibit 2.2 attached hereto (“the “**Wilson Letter Agreement**”);
- (e) an executed copy of a Letter of Credit in accordance with the terms of Section 8.4 of this Agreement; and
- (f) such other instruments or documents as may be necessary or appropriate to carry out the transactions contemplated hereby.

2.3 Deliveries by Sellers. Subject to the terms and conditions of this Agreement, in reliance on the representations, warranties and agreements of the Buyers contained in this Agreement, and in consideration of the Purchase Price for the Stock, the Sellers agree to deliver (or cause to be delivered) to the Buyers at the Auburn Closing those instruments listed below, all reasonably satisfactory in form and substance to the Buyers (the delivery of which may be waived in writing by the Buyers):

(a) stock certificates, with fully executed stock powers, evidencing the Stock and any other documentation necessary or appropriate to effect the transfer ownership thereof to Delta USA (and with respect to the Irish Closing, share certificates, with fully executed stock transfer forms, evidencing the Irish Stock and any other documentation necessary or appropriate to effect the transfer ownership thereof to Delta Holland);

(b) certificates of the Secretaries of the Sellers certifying as to the resolutions of the Sellers authorizing the transactions contemplated hereby;

(c) a certificate of good standing and/or subsistence, dated as of a recent date prior to the Auburn Closing, issued by the Secretary of State of the State of Kentucky and of each other jurisdiction in which the Company is qualified to do business;

(d) all corporate minute and stock books, stock ledgers and corporate seals of the Company and its Subsidiaries;

(e) written resignations from all officers and directors of the Company and its Subsidiaries;

(f) certificates signed by the Sellers certifying that the conditions to Auburn Closing described in Article VII have been fulfilled;

(g) evidence of receipt of all consents set forth on Schedule 3.3;

(h) an executed copy of the Wilson Letter Agreement;

(i) a list of all bank accounts, safe deposit boxes, brokerage accounts and other institutional accounts of the Company and its Subsidiaries as of the Auburn Closing Date together with complete executed corporate banking resolutions relating to all such accounts providing that Aviram Lahav has sole authority over the funds in such accounts;

(j) monthly Revenue Statements, listed by Customer, for the three-month period July 1, 2003 to September 30, 2003; and

(k) such other endorsements, instruments or documents as may be necessary or appropriate to carry out the transactions contemplated hereby.

At the Auburn Closing, the Sellers shall take all steps necessary to place the Delta USA in actual possession and operating control of the Business and the Company. At the Irish Closing, the Sellers shall take all steps necessary to place Delta Holland in actual possession and operating control of the Irish Subsidiary.

ARTICLE III REPRESENTATIONS AND WARRANTIES OF THE SELLERS

Each of the Sellers hereby, jointly and severally, represents and warrants to Buyers that each of the statements contained in this Article III is accurate, correct and complete as of the date hereof and as of the Auburn Closing Date.

3.1. Authority. Each of the Sellers has full right, power and authority, without the consent of any other person, to enter into this Agreement and the Related Documents to be executed and delivered by the Sellers pursuant hereto or in connection with the transactions contemplated hereby and thereby, and to consummate the transactions contemplated hereby and thereby. All acts or proceedings required to be taken by the Company or the Sellers to authorize the execution, delivery and performance of this Agreement and the Related Documents and the consummation of the transactions contemplated hereby and thereby have been duly and properly taken. For purposes of this Agreement, “**Related Documents**” shall mean all other agreements, instruments, documents and certificates to be executed and delivered pursuant to this Agreement

3.2. Validity. This Agreement has been, (and, when executed and delivered at Auburn Closing, each Related Document, will be) duly executed and delivered by, and constitute lawful, valid and legally binding obligations of Sellers enforceable in accordance with their respective terms. Except where consent is required by certain agreements listed in Schedule 3.3, the execution and delivery of this Agreement and each of the Related Documents and the consummation of the transactions contemplated hereby and thereby and compliance with the terms hereof and thereof does not and will not result in the creation of any Encumbrance of any kind upon any of the Company’s assets or give rise to a right of termination, cancellation or acceleration of any indebtedness or other obligation of the Company or to loss of a material benefit and are not prohibited by, do not violate or conflict with any provision of, and do not constitute a default under or a breach (with or without notice or lapse of time, or both) of (a) the articles of incorporation or by-laws of the Company, (b) any note, bond, mortgage, indenture, deed of trust, commitment, loan, contract, agreement, permit, license or other instrument to which the Company or Sellers is a party or by which the Company or Sellers or any of their respective properties or assets are bound, (c) any order, writ, injunction, decree or judgment of any court or governmental agency applicable to the Company or Sellers or the property or assets

of any of them, or (d) any statute, law, ordinance, rule or regulation applicable to the Company or Sellers or the property or assets or any of them.

3.3. Consents Except as set forth on Schedule 3.3, no material consent, approval, order or authorization of, or declaration, filing, registration or other action with any court, administrative agency or other governmental authority, and consent or waiver of any party to any Contract is required to be obtained by the Company or Sellers in connection with the execution, delivery and performance of this Agreement and each Related Document or the consummation by the Company or Sellers of the transactions contemplated hereby and thereby. For purposes of this Agreement, “**Contract**” shall mean any contract, license agreement, commitment, lease, or restriction of any kind to which the Company or any of its Subsidiaries is a party or by which the Company or any of its Subsidiaries is bound or to which any of the Company’s or any of its Subsidiaries’ assets are subject.

3.4. Capital Stock. (a) The Company’s entire equity capital consists of two thousand six hundred eighty (2,680) authorized shares, \$100.00 par value per share, of which there are two thousand six hundred eighty issued and outstanding shares, all of which are owned beneficially and of record by the Stockholder. The capitalization, including debt and equity, of the Company is accurately reflected in the Financial Statements in Schedule 3.6. All outstanding shares of Stock are duly authorized, validly issued, fully paid and nonassessable, are owned by the Stockholder free and clear of any Encumbrances, and were not issued in violation of any preemptive subscription or other right of any person to acquire securities and constitute in the aggregate all the issued and outstanding capital stock of all classes. Upon delivery to Delta USA at the Auburn Closing of certificates representing the Stock, good and valid title to the Stock will pass to Delta USA, free and clear of any Encumbrances. There is no outstanding subscription, option, convertible or exchangeable security, preemptive right, warrant, call or agreement (other than this Agreement) relating to the Stock or the capital stock of the Company and Subsidiaries or other obligation or commitment to issue any shares of Stock or capital stock of the Company and Subsidiaries. There are no voting trusts or other agreements, arrangements or understandings applicable to the exercise of voting or any other rights with respect to any Stock. Stockholder has good, marketable and indefeasible title to all of the Stock and the absolute right to sell, assign, transfer and deliver the Stock registered in Stockholder’s name to Delta USA, 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. The Company and the Sellers have not violated any applicable federal, state or foreign securities laws in connection with the offer and the sale of the Stock. Except for the Company’s Subsidiaries, the Company does not own stock or have any equity investment, membership or other interest in, does not have the right to acquire any such interest, and does not control, directly or indirectly, any corporation, limited liability company, association, partnership, joint venture or other entity and has not had such an ownership or control relationship with any such entity.

(b) The Irish Subsidiary has an authorized share capital of €6,346,690 divided into 5,000,000 ordinary shares of €1.269738 of which 1,723,800 are issued and fully paid and

all of which are owned beneficially by Spainco who is also the registered holder. The capitalization, including debt and equity, of the Irish Subsidiary is accurately reflected in the Financial Statements in Schedule 3.5. All shares of Irish Stock in issue are duly authorized, validly issued, fully paid and nonassessable, are owned by Spainco free and clear of any Encumbrances, and were not issued in violation of any preemptive subscription or other right of any person to acquire securities and constitute in the aggregate all the issued and outstanding share capital of all classes. Upon delivery to Delta Holland at the Irish Closing of certificates representing the Irish Stock, together with duly executed stock transfer forms, good and valid title to the Irish Stock will pass to Delta Holland, free and clear of any Encumbrances. There is no outstanding subscription, option, convertible or exchangeable security, preemptive right, warrant, call or agreement (other than this Agreement) relating to the Irish Stock or other obligation or commitment to issue any shares of Irish Stock. There are no voting trusts or other agreements, arrangements or understandings applicable to the exercise of voting or any other rights with respect to the Irish Stock. Spainco has good, marketable and indefeasible title to all of the Irish Stock and the absolute right to sell, assign, transfer and deliver the Irish Stock registered in Spainco's name to Delta Holland, 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. Spainco has not violated any applicable federal, state or foreign securities laws in connection with the offer and the sale of the Irish Stock.

3.5. Due Organization. Each of the Company and the Subsidiaries is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of their incorporation, and has full power and authority and all requisite rights, licenses, permits and franchises to own, lease and operate its assets and to carry on, in all material respects, the Business. Each of the Company and the Subsidiaries is duly licensed, registered and qualified to do business as a foreign corporation and is in good standing in all jurisdictions in which the ownership, leasing or operation of its assets or the conduct of its business requires qualification, except where such failure will not materially adversely affect the Business. Schedule 3.5 sets forth a complete list of the Company's Subsidiaries. Schedule 3.5 sets forth each state or other jurisdiction in which the Company and the Subsidiaries are licensed or qualified to do business. Each of the Company and the Subsidiaries has delivered to Buyers an accurate and complete copy of its articles of incorporation, by-laws and any other constituent documents.

3.6. Financial Statements. The unaudited financial statements of the Company and its Subsidiaries for the seven month period ended January 31, 2003 and the eight-month period ended September 30, 2003 attached hereto as Schedule 3.6 (the "**Financial Statements**") are, (a) accurate, correct and complete, (b) prepared in accordance with the books of account and records of the Company and its Subsidiaries, (c) present fairly the financial condition and results of operations of the Company and its Subsidiaries as of the dates and for the periods indicated and (d) prepared from the books and records of the Company but do not contain all of the footnotes required by generally accepted accounting principles ("**GAAP**") and are subject to year-end adjustments. 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 and fully and fairly reflect bona fide transactions set forth therein.

3.7. Interim Change. (a) Except as set forth on Schedule 3.7, since July 31, 2003:

(i) the Business has been conducted by the Company and its Subsidiaries only in the ordinary course consistent with past practices;

(ii) with respect to the Business, neither the Company nor any of its Subsidiaries has:

(A) suffered any damage, destruction or loss, whether or not covered by insurance, materially adversely affecting the Business;

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

(C) paid, discharged or satisfied any claims, liabilities or obligations (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 Financial Statements or incurred in the ordinary course of business and consistent with past practice

(D) made any material change 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) incurred any liabilities or obligations (absolute, accrued, contingent or otherwise), except in the ordinary course of business and consistent with past practice, or increased, or experienced any change in any assumptions underlying or methods of calculating, any bad debt, contingency or other reserves;

(F) permitted or allowed any of the Company's or any of its Subsidiaries' assets to be subjected to any Encumbrance (except Permitted Encumbrances and Encumbrances created by law). For the purposes of this Agreement, "**Permitted Encumbrances**" shall mean Encumbrances for Taxes not yet due and payable or Encumbrances for Taxes which are being contested in good faith, and Encumbrances which are not material to the value of the properties or assets encumbered and which do not impair in any material respect the current use or operation of such properties and assets.;

(G) made any single capital expenditure commitment in excess of \$20,000 for additions to property, plant, equipment or intangible capital assets or made capital expenditure commitments in excess of \$50,000 in the aggregate for additions to property, plant, equipment or intangible capital assets;

(H) made any material change in the manner in which products or services have been developed or marketed;

(I) made any material reductions in inventory levels;

(J) made any material change in pricing policies relating to products of the Business (whether or not in the ordinary course of business);

(K) had any labor dispute or received notice of any grievance;

(L) borrowed or agreed to borrow any funds;

(M) other than cash and cash equivalents, paid and/or declared any dividends with respect to its shares of capital stock, whether in shares of capital stock or other property;

(N) granted to any officer or employee any increase in compensation or benefits, other than increases in compensation or benefits to employees in the ordinary course of business and consistent with past practice;

(O) paid any pension, retirement allowance or other employee benefit not required by any plan, policy or program identified on Schedule 3.29(a) hereto or any employment agreement set forth on Schedule 3.19 hereto;

(P) adopted, agreed to adopt, or made any announcement regarding the adoption of (i) any new pension, retirement or other employee benefit plan, program or policy, or (ii) any amendments to any existing pension, retirement or other employee benefit plan, policy or program identified on Schedule 3.29 (a) unless otherwise required by applicable law; or

(Q) suffered or agreed to take any of the actions set forth in this subparagraph (ii).

3.8. Banking Relationships and Investments. Schedule 3.8 sets forth a correct and complete list of all banks and financial institutions in which the Company and its Subsidiaries has an account, deposit, safe-deposit box, lock box or other similar relationship related to the Business, including the names of all persons authorized to draw on those accounts or deposits, or to obtain access to such boxes.

3.9. Accounts Receivable. Schedule 3.9 sets forth a correct and complete aging of all outstanding accounts and notes receivable as of September 30, 2003. All outstanding accounts and notes receivable reflected on the Financial Statements are due and valid claims against account debtors for goods or services delivered or rendered, and subject to no defenses, offsets or counterclaims known to the Company, except as properly reserved against on the Financial Statements in accordance with GAAP. 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.

3.10. Inventory. Except as set forth on Schedule 3.10, all inventories reflected on the Financial Statements are (a) properly valued at the lower of cost or market value in accordance with GAAP as consistently applied in prior annual financial statements; (b) of normal quantity and mix and of good and merchantable quality and contain no material amounts (except as appropriately reserved) that are not salable and usable for the purposes intended in the ordinary course of business and meet the current standards and specifications of the Business. All inventories disposed of subsequent to September 30, 2003, have been disposed of only in the ordinary course of business and at prices and under terms that are normal and consistent with past practice. No inventory is held by the Company on consignment, and the Company does not hold title to any inventory held by others, except as set forth on Schedule 3.10.

3.11. Tangible Property. Schedule 3.11 sets forth a correct and materially complete list of all Tangible Property and motor vehicles used in the Business, whether owned or leased. All Tangible Property of the Company is in good operating condition and repair, reasonable wear and tear excepted, and all such Tangible Property is adequate for the uses to which it is being put. None of such Tangible Property is in need of maintenance or repairs except for ordinary, routine maintenance and repairs which are not material in nature or cost. All such motor vehicles are (a) properly licensed and registered in accordance with applicable law and (b) insured as set forth in Schedule 3.12. For purposes of this Agreement, “Tangible Property” shall mean all computer equipment and other machinery, furniture, equipment and other tangible personal property owned by the Company.

3.12. Insurance. Schedule 3.12 sets forth a correct and complete list of all binders, policies of insurance, self insurance programs or fidelity bonds (“**Insurance**”) maintained by the Company and its Subsidiaries or in which the Company or its Subsidiaries is a named insured, true and complete copies of which have been provided or made available to the Buyer. There are no pending or asserted claims against any Insurance as to which any insurer has denied liability, and there are no claims under any Insurance that have been disallowed or improperly filed. Schedule 3.12 sets forth the claims experience for the last full fiscal year and the interim period through the date hereof with respect to the Business (both insured and self-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. None of Sellers has knowledge of any facts or the occurrence of any event which reasonably might form the basis of any claim against the Company or its Subsidiaries.

3.13. Title to Assets. Except as set forth on Schedule 3.13 to this Agreement, the Company or its Subsidiaries are the sole and exclusive legal and equitable owners of all right, title and interest in and has good and marketable title to the properties and assets used by it, located on its premises or shown on the most recent Financial Statement or acquired thereafter, free and clear of all Encumbrances. The Company or its Subsidiaries owns, and immediately after the Auburn Closing the Company or its Subsidiaries will continue to own, all assets necessary for the conduct of the Business as presently conducted by the Company. Except as set forth on Schedules to this Agreement, none of the assets of the Company and its Subsidiaries are subject to any material (i) title defect or objection; (ii) contract of lease, license or sale to a third party; (iii) security interest, mortgage, pledge, lien, charge or encumbrance of any kind or character, direct or indirect, whether accrued, absolute, contingent or otherwise, except minor liens and encumbrances which do not materially detract from the value or interfere with the

present use thereof; (iv) royalty or commission arrangement; or (v) claim, covenant or restriction. The assets of the Company and its Subsidiaries are in good operating condition and repair (reasonable wear and tear excepted) reasonably suitable for the purposes for which they are presently being used. None of such assets are in need of maintenance or repairs except for ordinary, routine maintenance and repairs which are not material in nature or cost. No equipment, tooling, forms, patterns or similar assets owned by the Company or its Subsidiaries are in the hands of vendors.

3.14. Real Estate

(a) Schedule 3.14(a) sets forth a correct and complete list of each parcel of Real Property and the ownership interest of the Company or a Subsidiary (the **“Owned Real Estate”**). The Company or its Subsidiaries have good, marketable and insurable interests in and to the Owned Real Estate. The Company or a Subsidiary is in possession of all Owned Real Estate, including the buildings, structures and improvements situated thereon and appurtenances thereto, in each case free and clear of all tenancies and other possessory interests, security interests, conditional sale or other title retention agreements, liens, encumbrances, mortgages, pledges, assessments, easements, rights of way, covenants, restrictions, reservations, options, rights of first refusal, defects in title, encroachments and other burdens, except those which do not impair the use of the Owned Real Estate. For the purposes of this Agreement, **“Real Property”** shall mean all fee or leasehold interests, easements, real estate licenses, rights to access or other rights with respect to real property that is owned or held by the Company or its Subsidiaries.

(b) No portion of any Owned Real Estate owned, leased, occupied or used in the Business has been condemned, requisitioned or otherwise taken by any public authority, and, to the knowledge of Sellers, no such condemnation, requisition or taking is threatened or contemplated. The Owned Real Estate is in compliance in all material respects with all applicable zoning, building, health, fire, water, use or similar statutes, codes, ordinances, laws, rules or regulations. To the knowledge of Sellers, the zoning of each parcel of Owned Real Estate permits the existing improvements and the continuation of the Business as presently conducted thereon. The Company has all material licenses, certificates of occupancy, permits and authorizations required to operate the Business and utilize the Owned Real Estate. The Company has all easements and rights necessary to conduct the Business, including easements for all utilities, services, roadway, railway and other means of ingress and egress.

(c) The Company has delivered to the Buyers correct and complete copies of title insurance policies, title reports, and existing surveys, environmental audits and similar reports with respect to each parcel of Owned Real Estate.

(d) Schedule 3.14(d) sets forth a correct and complete list of all Real Property leased or subleased by the Company or a Subsidiary (the **“Real Estate Leases”**), which together with the Owned Real Estate constitutes all of the Real Property relating to the

Business. With respect to each Real Estate Lease, (i) each is in full force and effect and is binding and enforceable in accordance with its terms; (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 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 Sellers, threatened, by the lessor under any Real Estate Lease; (vi) except for the security deposits identified on Schedule 3.14(d) hereto, no lessor holds any deposits for the Company's accounts under any Real Estate Lease; (vii) except as set forth on Schedule 3.3 hereto, the consummation of the sale of the 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 3.14(d) hereto. Minimum monthly rent and additional rent under the Real Estate Leases are set forth on Schedule 3.14(d) hereto. Other than as set forth on Schedule 3.14(d), there are no parties in possession of any portion of the Real Property subject to the Real Estate Leases, whether as leases, tenants at will, trespassers or otherwise. At the Auburn Closing, the Company shall deliver to Buyer any consents or approvals of any parties required in connection with the assignment of the Real Estate Leases to Buyer.

(e) All required licenses, permits, certificates and approvals, including building and use permits, planning permissions and building regulations consents (collectively, the “**Real Property Permits**”), were obtained and remain valid for the construction, use and occupancy and operation of the Real Property. Each parcel of Real Property and all improvements located thereon are zoned or have a variance or conditional use permit or valid planning permission for the intended 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 and complies in all material respects with the requirements of all conditions, covenants and restrictions applicable thereto. There are no pending or, to the knowledge of the Company or Sellers, threatened, actions or proceedings that might prohibit, restrict or impair the use and occupancy of any Real Property, or result in the suspension, revocation, impairment, forfeiture or non-renewal of any of the Real Property Permits.

3.15. Personal Property Leases. Schedule 3.15 sets forth a correct and complete list of all leases or bailments of personal property used in the Business requiring payments in excess of \$50,000 per year (the “**Personal Property Leases**”). The Company is in peaceable possession of the property covered by each Personal Property Lease. The Company has delivered to Buyer an accurate and complete copy of each Personal Property Lease. At the

Auburn Closing, the Company shall deliver to Buyers any consents or approvals of any parties required in connection with the assignment of the Personal Property Leases to Buyers.

3.16. Intellectual Property. Schedule 3.16 sets forth a true, correct and complete list and description (showing in each case any product, device, process, service, advertising program, business or publication covered thereby, the registered or other owner, registration number, and registration or other expiration date, if any) of all Patent Rights, Trademarks and Copyrights owned or licensed by the Company or its Subsidiaries (the “**Intellectual Property**”). Schedule 3.16, sets forth the nature of the Company’s rights (or grant of rights), any limitations thereon, the owner of such rights (or the licensee/licensor or grantee/grantor of such rights and the nature of such grant). With respect to the Intellectual Property:

(a) Except as set forth on Schedule 3.16, the Company or its Subsidiaries are the sole and exclusive owners of the Intellectual Property and has the sole and exclusive right to use the Intellectual Property;

(b) Except as set forth on Schedule 3.16 (i) no action, suit, proceeding or investigation is pending or, to the Stockholder’s knowledge, threatened; (ii) to Sellers’ knowledge, none of the Intellectual Property interferes with, infringes upon, conflicts with or otherwise violates the rights of others or is being interfered with or infringed upon by others, and none is subject to any outstanding order, decree, judgment, stipulation or charge; (iii) there are no royalty, commission or similar arrangements requiring any further payment by the Company or by Buyers as the successor in interest to the Company, (iv) the Company has not agreed to indemnify any person for or against any infringement of or by the Intellectual Property; (v) Sellers have no knowledge of any patent, invention or application therefor or similar property which would infringe upon any of the Intellectual Property or render obsolete or adversely affect the manufacture, processing, distribution or sale of products or services relating to the Business; and (vi) all items of Intellectual Property owned by the Company are properly registered under applicable law and all such registrations are valid and in force, and in the case of applications, all patent applications with respect to Patent Rights and all applications to register any Trademarks are pending and in good standing, all without challenge of any kind;

(c) Except as set forth on Schedule 3.16, none of the Intellectual Property is subject to any extensions, renewals, taxes or fees due within thirty (30) days after Auburn Closing;

(d) All rights of the Company in and to the Intellectual Property are freely transferable without any consent, approval or payment which has not already been obtained or made by the Company;

(e) The Company is not subject to any judgment, order, writ, injunction or decree of any court or any federal, state, local or other governmental agency or instrumentality, domestic or foreign, or any arbitrator, nor is a party to any contract which restricts or impairs the use of any Intellectual Property;

(f) To Sellers' knowledge, 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; and

(g) For purposes of this Agreement, the following terms shall have the following meanings:

(i) **"Copyrights"** means registered United States and foreign copyrights, copyrightable works, mask works and pending applications to register the same, and all agreements, contracts, licenses, sublicenses, assignments and indemnities that relate or pertain to any of the foregoing;

(ii) **"Patent Rights"** means United States and foreign patents, patent applications, continuations, continuations-in-part, divisions, reissues, patent disclosures, inventions (whether or not patented) or improvements thereto, and all agreements, contracts, licenses, sublicenses, assignments and indemnities that relate or pertain to any of the foregoing; and

(iii) **"Trademarks"** means United States, state and foreign trademarks, service marks, logos, trade dress, trade styles, trade names (including all assumed or fictitious names under which the party is conducting business or has within the past five years conducted business), product designations, labels, logos, designer designations, brands, and any other source-identifying devices or symbols, and any combination or variations thereof, whether registered or unregistered, and pending applications to register the foregoing and all registrations thereof, and all agreements, contracts, licenses, sublicenses, assignments and indemnities that relate or pertain to any of the foregoing.

3.17. Software and Information Systems. Except as set forth in Schedule 3.17 (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 3.17, the Customized Software is not subject to any transfer, assignment, source code escrow agreement, reversion, site, equipment, or other operational limitations; and

Copies of all Software owned by the Company or a Subsidiary and copies of all licenses and other agreements with respect to Customized Software shall be delivered to Buyers at Auburn Closing.

3.18. Customers and Suppliers. All sales contracts and orders with customers and suppliers existing as of the Auburn Closing were entered into by or on behalf of the Company or a Subsidiary and were entered into in the ordinary course of business for usual quantities and at normal prices. Schedule 3.18 sets forth a correct and complete list of the 10 largest customers, 10 largest vendors and 10 largest contractors of the Business, determined on the basis of revenues from items sold (with respect to customers) or costs of items purchased (with respect to suppliers) for the fiscal year ended January 31, 2003. The Company is not aware that any customer or supplier listed on Schedule 3.18 will materially reduce the level of, or cease to do business with the Company or Subsidiaries after the consummation of any transactions contemplated hereby. Since September 30, 2003, there has been no cancellation of backlogged orders in excess of the average rate of cancellation prior to such date, except as may have occurred in relation to the Shutdown of the Irish facilities. Customer returns and inventory stock adjustments since September 30, 2003 have not been excessive in relation to the circumstances of the Business and are in accordance with past practices.

To the knowledge of the Sellers, neither the Company nor any of its officers or employees, has, directly or indirectly, given or agreed to give any rebate, gift or similar benefit to any supplier, customer, distributor, broker, governmental employee or other person, who was, is or may be in a position to help or hinder the business (or assist in connection with any actual or proposed transaction) which could subject the Company or Buyers to any damage or penalty in any civil, criminal or governmental litigation or proceeding or which would have a material adverse effect on the Business.

3.19. Employees.

(a) Contracts. Schedule 3.19(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 (the “**Employment Contracts**”), copies of which have been provided to the Buyer. The Sellers do not have any employment or other compensation arrangements with, nor do they 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 3.19(a) are employed “at-will” by the Company or a Subsidiary.

(b) Compensation. Schedule 3.19(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 or position, the present annual compensation (including, without limitation, bonuses, commissions and deferred compensation), 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 3.19(b) sets forth an accurate and complete list of each employee who may become entitled to receive supplementary retirement benefits or allowances, whether pursuant to a contractual obligation or otherwise, and the estimated amounts of such payments. Since January 31, 2003, except as disclosed on Schedule 3.19(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. No Employee is eligible for payments that would, alone or in conjunction with any other payment, constitute “parachute payments” under Section 280G of the Code.

(c) Disputes. Schedule 3.19(c) sets forth an accurate and complete list of the unions that represent any Employees of the Company or a Subsidiary and any collective bargaining agreements to which the Company or a Subsidiary is a party or subject to. There are no controversies pending or, to the knowledge of Sellers, threatened, involving any group of Employees, except individual grievances under any collective bargaining agreement which, in the aggregate, are not material. The Company has not suffered or sustained any labor strike, work stoppage or lock out and no such labor strike, work stoppage or lock out is threatened. No union organizing or election activities involving any nonunion employees of the Company are in progress or threatened and no question concerning representation exists with respect to any Employees.

(d) Compliance. The Company has complied in all material respects with all laws relating to the employment of labor and employment practices, including, without limitation, provisions relating to terms and conditions of employment, wages, hours, equal opportunity, record keeping, occupational health and safety, severance, collective bargaining and the payment of social security and other taxes and is not engaged in any unfair labor practice.

(e) 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.

(f) There are no loans outstanding from the Company to any of the Employees.

(g) The Company is not in breach of any material terms of employment of any of the Employees nor to the knowledge of Sellers or the Company is any Employee in breach of any material term of his or her employment relationship.

(h) Except as specifically set forth on Schedule 3.19(h), as of the date hereof, none of the Employees has given or received notice of termination of his or her employment.

(i) To the knowledge of the Sellers, the Company has since January 1, 1993 complied in all material respects with the employment eligibility verification form requirements under the Immigration and Naturalization Act, as amended (“INA”), in recruiting, hiring, reviewing and documenting prospective employees for employment eligibility verification purposes and the Company has complied in all material respects with the paperwork provisions and anti-discrimination provisions of the INA. To the knowledge of the Sellers, the Company has since January 1, 1993 obtained and maintained the employee records and I-9 forms in proper order as required by United States law. To the knowledge of Sellers and the Company, the Company does not employ any workers unauthorized to work in the United States.

(j) As of the Auburn Closing, the Company, its Subsidiaries and any entity with which the Company or any Subsidiary could be considered a single employer under 29 U.S.C. Section 2101(a)(1) or under any relevant case law, has not incurred any liability or obligation under the Worker Adjustment and Retraining Notification Act, as if may be amended from time to time, and within the 90-day period immediately following the closing, will not incur any such liability or obligation if, during such 90-day period, only terminations of employment in the normal course of operations occur.

3.20. Licenses and Permits. Schedule 3.20 contains a correct and complete list of each material license, permit, certificate, approval, exemption, franchise, registration, variance, accreditation or authorization issued and used in the Business (collectively, the “**Licenses and Permits**”). The Licenses and Permits are valid and in full force and effect and there are not pending or, to the knowledge of Sellers, threatened, any proceedings which could result in the termination, revocation, limitation or impairment of any License or Permit. The Company has all licenses, permits, certificates, approvals, franchises, registrations, accreditations and other authorizations as are necessary or appropriate in order to enable it to own and conduct its business and to own, occupy and lease its Real Property. No material violations have been recorded in respect of any Licenses and Permits, and Sellers know of no meritorious basis therefor. No material fines or penalties are due and payable in respect of any License or Permit or any violation thereof.

3.21. Material Contracts. Schedule 3.21 sets forth a correct 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 Software, Employment Contracts, Benefit Plans and Licenses and Permits;

(b) Any contract for capital expenditures or for the purchase of goods or services in excess of \$50,000;

(c) Any purchase order, agreement or commitment obligating the Company to sell or deliver any products with an aggregate value exceeding \$100,000 or at a price which does not cover the cost (including labor, materials and production overhead) plus at least eighty percent (80%) of the customary profit margin associated with such product;

(d) Any financing agreement or other agreement for borrowing money, and 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 use of 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 or preferential rights to purchase or sell any assets;

(l) Any contract to indemnify any party or to share in or contribute to the liability of any party;

(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 \$50,000 or more or (ii) is between an Affiliate and the Company; and

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

Correct and complete copies of each Material Contract have been delivered to Buyers. Each Material Contract is in full force and effect and is valid, binding and enforceable in accordance with its terms. Each party has complied with all material commitments and obligations on its part to be performed or observed under each Material Contract prior to the date hereof. No event has occurred which is or, after the giving of notice or passage of time, or both, would constitute a default under or a breach of any Material Contract by the Company, or, to the knowledge of Sellers, by any other party. 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. Except as set forth in Schedule 3.3, the consummation of the transactions contemplated hereby, without notice to or consent or approval of any party, will not constitute a default under or a breach of any provision of a Material Contract, and Buyers will have and may enjoy and enforce all rights and benefits under each Material Contract. There is no security interest, lien, Encumbrance or claim of any kind on the Company's interest under any Material Contract.

3.22. Taxes.

(a) All Tax Returns required to be filed by or on behalf of each of the Company and the Subsidiaries have been duly filed on a timely basis, except where the failure to file would not have a material adverse affect on the financial condition of the Company or the Subsidiaries, and such Tax Returns are true, complete and correct in all material respects. All Taxes (whether or not required to be shown on any Tax Return) required under applicable Tax Law to have been

paid by each of the Company and the Subsidiaries have been paid in full on a timely basis. No other Taxes are payable by each of the Company and the Subsidiaries with respect to items or periods covered by such Tax Returns or with respect to any period prior to the date of this Agreement. With respect to all Taxes of each of the Company and the Subsidiaries not yet due and payable (excluding Taxes attributable to Final Group Items), and with respect to Taxes which would be imposed on the Company pursuant to Code Section 951 (or any analogous or similar state or local law or regulation) with respect to the Subsidiaries if the Auburn Closing Date were the last day of each Subsidiary's taxable year (and taking into account Code Section 951(a)(2)(B)), the Company or the Subsidiaries, as the case may be, have established an adequate reserve on their respective books and financial records as of the Auburn Closing Date for the payment of such Taxes, and the amount of such Taxes does not, in the aggregate, exceed such reserves for such Taxes as reflected on the books and financial records of the Company or the Subsidiaries, as the case may be. The Company and the Subsidiaries have timely withheld and paid over to the relevant Tax Authority all Taxes required to have been withheld and paid over, and timely complied with all information reporting and backup withholding requirements, including maintenance of required records with respect thereto, in connection with amounts paid or owing to any employee, creditor, independent contractor, or other third party.

(b) To the knowledge of the Sellers, except as otherwise provided for on Schedule 3.22, neither the Tax Returns of the Company nor the Subsidiaries has ever been subject to an Audit during the last seven years, nor is there any such Audit in progress, pending or threatened (either in writing or verbally, formally or informally) nor have the Sellers, the Company, or the Subsidiaries been notified, formally or informally, or expects to be notified by any Tax Authority or are the Sellers otherwise aware, that any such Audit is contemplated, threatened or pending. To the knowledge of the Sellers, except as otherwise provided for on Schedule 3.22, no information regarding any Tax matter relating to the Company or the Subsidiaries has been requested by any Tax Authority and no issue has been raised or is currently pending by any Tax Authority in connection with any of the Tax Returns of the Company or the Subsidiaries.

(c) There are no claims, investigations, actions or proceedings pending or, to the knowledge of Sellers, threatened, against the Company or the Subsidiaries by any Tax Authority for any past due Taxes with respect to which the Company or the Subsidiaries would be liable. There has been no waiver of any applicable statute of limitations nor any consent for the extension of the time for the assessment of any Tax against the Company or its Subsidiaries.

(d) Neither the Company nor the Subsidiaries is delinquent in the payment of any Taxes and there are no Tax liens upon any property or assets of the Company or the Subsidiaries, except liens for Taxes not yet due and payable.

(e) The Company is not currently required to make any adjustment under any state or local Tax Law provision comparable to Section 481(a) of the Code by reason of a change in accounting method or otherwise.

(f) Except under Treasury Regulations Section 1.1502-6 (and comparable provisions of any other applicable Tax Law), neither the Company nor the Subsidiaries are liable for the Taxes of any Person including, without limitation, as a transferee or successor, or by

contract, indemnity or otherwise. To the knowledge of the Sellers, the Company has never been a member of an affiliated group filing consolidated returns other than the Group and other than a Group in which Gerber Childrenswear Inc. was the common parent.

(g) Neither the Company nor the Subsidiaries are currently, or to the knowledge of the Sellers have ever been, a party to any Tax sharing agreement, Tax indemnity agreement or other similar Tax sharing arrangement.

(h) Neither the Company nor the Subsidiaries are required to file Tax Returns in any state, local, territorial or foreign taxing jurisdiction other than those for which all Tax Returns have been furnished to Buyer. To the knowledge of Sellers, no claim has ever been issued by any Tax Authority in a jurisdiction where the Company, any Subsidiary, or any Tax Relevant Person (to the extent on behalf of the Company or the Subsidiaries) does not file Tax Returns that it is or may be subject to taxation by that jurisdiction.

(i) Schedule 3.22 sets forth all the states and other local jurisdictions where the Company and the Subsidiaries file income or franchise Tax Returns (or similar type of Tax Returns).

(j) Kellwood has provided to the Buyers true and complete copies of all Tax Returns of the Company and the relevant portion of all federal and state income and franchise consolidated, unitary or combined Tax Returns of each Group which includes any of the Company's items of income, gain, loss, deduction or credit for all periods beginning on or after January 1, 2000.

(k) To the knowledge of Sellers, (1) the Company has not filed a consent pursuant to the collapsible corporation provisions of Section 341(f) of the Code (or any corresponding provision of state, local or foreign income tax law); (2) the Company is not a party to any safe harbor lease within the meaning of Section 168(f)(8) of the Code, as in effect prior to amendment by the Tax Equity and Fiscal Responsibility Act of 1982; (3) neither the Company nor any Subsidiary has been a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code during the applicable period specified in Section 897(c)(1)(A)(ii) of the Code and Buyers are not required to withhold tax on the purchase of the stock of the Company by reason of Section 1445 of the Code; (4) the Company has not entered into any compensatory agreements with respect to the performance of services which payment thereunder would result in a nondeductible expense pursuant to Section 280G of the Code or an excise tax to the recipient of such payment pursuant to Section 4999 of the Code; and (5) the Company has not participated in an international boycott as defined in Section 999 of the Code.

3.23. Product Warranty. All products manufactured, marketed, distributed, shipped or sold by the Company or a Subsidiary have been in material conformity with all applicable contractual commitments and all expressed warranties. No liability exists or will arise for repair, replacement or damage in connection with such sales or deliveries, in excess of the reserve therefor on the Financial Statements. Schedule 3.23 sets forth a correct and complete statement of all written warranties, warranty policies, service and maintenance agreements of the Business. All warranties 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 31, 2003 and the interim period through the date hereof is set forth in Schedule 3.23. No products heretofore manufactured, marketed, distributed, shipped or sold by the Company or a Subsidiary are now subject to any guarantee, warranty, claim for product liability, or patent or other indemnity, other than those set forth in Schedule 3.23.

3.24. Product Liability. Schedule 3.24 sets forth a correct and complete list of all existing claims, for the period ended September 30, 2003 and the interim period through the date hereof, arising from or alleged to arise from any injury to person or property or economic damage as a result of the ownership, possession or use of any product manufactured, marketed, distributed, shipped or sold prior to the Auburn Closing Date. Except as set forth in Schedule 3.24, neither the Company nor any Subsidiary is or will be subject to any claim, expense, liability or obligation arising from any injury to person or property as a result of ownership, possession or use of any product sold prior to the Auburn Closing Date. All claims are fully covered by Insurance. There have been no recalls, and none is threatened or pending, and to the knowledge of Sellers, no report has been filed or is required to have been filed with respect to any products of the Business under the Consumer Products Safety Act, as amended, or under any other law, rule or regulation. To the knowledge of Sellers, no circumstances exist involving the safety aspects of the Business' products which would cause any obligation to report to any federal, state or local agency. Except as set forth on Schedule 3.24, there are no, and within the last twelve months there have not been any, actions or claims relating to product liability against or involving the Company, or any of its Subsidiaries, or any of their respective products and no actions or claims have been settled, adjudicated or otherwise disposed of within the last twelve months.

3.25. Legal Proceedings. Except as set forth in Schedule 3.25, neither the Company nor any Subsidiary is engaged in or a party to or threatened with any action, suit, proceeding, complaint, charge, hearing, investigation or arbitration or other method of settling disputes or disagreements. Neither the Company nor any Subsidiary has received 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, nor the Business nor any of its assets is subject to any judgment, award, order, writ, injunction, stipulation or decree of any court or any governmental agency or any arbitrator. Neither the Company nor any Subsidiary has received any 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 transactions contemplated hereby or the Business. Except as set forth on Schedule 3.25, no insurance company has asserted in writing that such action is not covered by the applicable policy relating thereto.

3.26. Environmental Matters.

(a) Compliance. Except as set forth in Schedule 3.26(a), the Company and each Subsidiary is currently in material compliance with all Environmental Laws.

Except as set forth on Schedule 3.26(a), there has been no Release of Hazardous Substances at any location or property currently or formerly owned by the Company,

each Subsidiary or a predecessor in interest. There has not been a Release of Hazardous Substances at any disposal or treatment facility which received Hazardous Substances generated by the Company, each Subsidiary or any predecessor in interest.

(b) Environmental Permits. The Company and its Subsidiaries have all Environmental Permits necessary for the conduct and operation of the Business, and all such permits are in good standing or, where applicable, a renewal application has been timely filed and is pending agency approval, and the Company and its Subsidiaries are in compliance with all terms and conditions of all such Environmental Permits and are not required to make any expenditure in order to obtain or renew any Environmental Permits, except where the failure to obtain or be in such compliance and the requirement to make such expenditure would not have a material adverse effect on the Business. For purposes of this Agreement, “**Environmental Permits**” shall mean permits required by Environmental Laws.

(c) Environmental Claims. Except as set forth on Schedule 3.26, no Environmental Claims have been asserted or, to the knowledge of Sellers and the Company, there are not any threatened or pending Environmental Claims, against the Company, any Subsidiary, or any predecessor in interest. No Environmental Claims have been asserted against any facilities that may have received Hazardous Substances generated by the Company or any predecessor in interest.

(d) Certain Definitions. For purposes of this Agreement:

“**Environmental Claims**” shall mean any and all claims, actions, causes of action, or other written notices by any Person or entity alleging potential liability (including, but not limited to, potential liability for investigatory costs, Remedial Actions, cleanup costs, governmental response costs, natural resources damages, property damages, personal injuries, or civil or criminal penalties) arising out of or resulting from (i) circumstances forming the basis of any violation of any Environmental Laws or (ii) any Releases of Hazardous Substances at any real or personal property presently or formerly owned, leased or managed by the Company, any Subsidiary or a predecessor in interest or at any disposal facility which may have received Hazardous Substances generated by the Company, any Subsidiary or a predecessor in interest.

“**Environmental Law**”, means any present and future federal, state and local laws, statutes, ordinances, rules, regulations and the like (whether of the United States or another jurisdiction), as well as common law, relating to protection of human health or the environment, relating to Hazardous Substances, relating to liability for or costs of Remediation or prevention of Releases of Hazardous Substances or relating to liability for or costs of other actual or future danger to human health or the environment. The term "Environmental Law" includes, but is not limited to, the following statutes, as amended, any successor thereto, and any regulations promulgated pursuant thereto, and any state or local statutes, ordinances, rules, regulations and the like of any jurisdiction addressing similar issues: the Comprehensive Environmental Response, Compensation and Liability Act; the Emergency Planning and Community Right-to-Know Act; the Hazardous Substances Transportation Act; the Resource Conservation and Recovery Act

(including but not limited to Subtitle I relating to Underground Storage Tanks); the Clean Water Act; the Clean Air Act; the Toxic Substances Control Act; the Safe Drinking Water Act; the Occupational Safety and Health Act; the Federal Insecticide, Fungicide and Rodenticide Act and the Endangered Species Act. The term "Environmental Law" also includes, but is not limited to, any present and future federal, state and local laws, statutes, ordinances, rules, regulations and the like (whether of the United States or another jurisdiction), as well as common law requiring notification and/or approval of state or local authorities for transfer of property; requiring notification or disclosure of Releases of Hazardous Substances or other environmental condition of the Real Property relating to nuisance, trespass or other causes of action related to the Real Property; and relating to wrongful death, personal injury, or property or other damage in connection with any physical condition or use of the Real Property.

"Environmental Liabilities" means any monetary obligations, losses, liabilities (including strict liability), damages, punitive damages, consequential damages, treble damages, costs and expenses (including all reasonable out-of-pocket fees, disbursements and expenses of counsel, out-of-pocket expert and consulting fees and out-of-pocket costs for environmental site assessments, Remedial Actions and feasibility studies, natural resources damages, property damages, personal injuries), civil or criminal penalties fines and, penalties, sanctions and interest incurred as a result of any Environmental Claim filed by any Governmental Authority or any third party.

"Hazardous Substances" includes but is not limited to any and all substances (whether solid, liquid or gas) defined, listed, or otherwise classified as pollutants, hazardous wastes, hazardous substances, Hazardous Substances, extremely hazardous wastes, special waste, solid waste or words of similar meaning or regulatory effect under any present or future Environmental Laws or that may have a negative impact on human health or the environment, including but not limited to petroleum and petroleum products, asbestos and asbestos-containing materials ("ACM"), polychlorinated biphenyls ("PCBs"), lead, lead-based paints, radon, radioactive materials, flammables and explosives.

"Release" means but is not limited to any any spilling, leaking, pumping, emitting, emptying, discharging, injecting, escaping, leaching, migrating, dumping, or disposing of Hazardous Substances (including the abandonment or discarding of barrels, containers or other closed receptacles containing Hazardous Substances) into the indoor or outdoor environment.

"Remedial Actions" means all actions taken to (i) clean up, remove, remediate, contain, treat, monitor, assess, evaluate or in any other way address Hazardous Substances in the indoor or outdoor environment; (ii) prevent or minimize a Release or threatened Release of Hazardous Substances so they do not migrate or endanger or threaten to endanger public health or welfare or the indoor or outdoor environment; (iii) perform pre-remedial studies and investigations and post-remedial operation and maintenance activities; or (iv) any other actions authorized by 42 U.S.C. 9601.

3.27. Compliance with Law. The operation of the Business and the Company's and each Subsidiary's ownership and use of its assets conform to all applicable laws, except for such minor violations as do not impair or interfere with the Business or the use for which such assets are employed. The Company and each Subsidiary has complied with all material laws applicable to its business or operations, including without limitation, those relating to employment, employee benefits, the production, marketing, sale and distribution of products, labeling of products, trade regulation, antitrust, warranties and control of foreign exchange, and there is not and should not be any liability arising from or related to any violations thereof. No written notice from any governmental body or other person of any violation of any laws, or requiring or calling attention to the necessity of any repairs, installation or alteration has been served. Neither the Company, nor any officer, agent or employee of the Company, nor, to the knowledge of Sellers, 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.

3.28. Absence of Undisclosed Liabilities. Except as may relate to the Shutdown of the Irish facilities or except to the extent reflected on the balance sheet as of September 30, 2003, or on a Schedule attached hereto, the Company does not and will not have any material indebtedness, duty, responsibility, liability or obligation of any nature, whether absolute, accrued, contingent or otherwise, related to or arising from the operation of the Business or the ownership, possession or use of its assets through the Auburn Closing Date other than in the ordinary course of its business on terms and conditions and in amounts consistent with past practices.

3.29. United States Employee Benefits. With respect to the Company's Employees located in the United States:

- (a) Attached hereto as Schedule 3.29(a) is a list of each pension, profit-sharing, deferred compensation, retirement, welfare benefit or other plan or arrangement providing benefits to or arising out of the employment or the termination of any employee, former employee, sales personnel or retiree of the Company, whether written or oral, tax-qualified under the Code or non-qualified, whether covered by the Employee Retirement Income Security Act of 1974, as amended (the "ERISA") or not, including, without limitation, those that constitute employee benefit plans within the meaning of Section 3(3) of the ERISA, currently maintained or contributed to by the Company for the benefit of their employees or retirees (each, a "Plan") which indicates for each Plan whether the Plan is sponsored by the Company or the Sellers. Neither the Company nor the Sellers has any legally binding oral or written plan or

other commitment, whether covered by ERISA or not, to create or participate in any additional plan, agreement or arrangement (other than a Plan) or to modify or change any existing Plan in any manner that would affect any of the Company's employees, former employees, retirees or sales personnel, other than modifications or changes required by applicable law. The Sellers and the Company have made available to Buyer true and complete copies of the Plans, the trusts and other contracts (including, without limitation, any amendments to any of the foregoing) relating to the Plans and all other relevant documents governing or relating to the Plans in effect on the date hereof (including without limitation, the latest plan document, summary plan description, the latest annual report (and all attachments) filed with the Internal Revenue Service with respect to each of the Plans, and the latest favorable determination letter issued by the Internal Revenue Service for each of the Plans, as applicable).

- (b) Except as set forth in Schedule 3.29(b), neither the Company nor any corporation or other trade or business under common control with the Company (as determined pursuant to Section 414 (b) or (c) of the Code) ("Commonly Controlled Entity") is presently, and has ever been, a participating employer in any "multi-employer plan" as defined in Section 3(37) of ERISA or Section 414(f) of the Code or any "employee pension benefit plan" as defined in Section 3(2) of ERISA which is subject to Title IV of ERISA or Section 412 of the Code. Any employee benefit plan or arrangement that the Company or any Subsidiary previously contributed to or maintained, or that was maintained or contributed to by any Commonly Controlled Entity that has been terminated has been terminated in accordance with all applicable laws and no residual liabilities remain with respect to such termination(s).
- (c) Except as set forth on Schedule 3.29(c), the Company has no obligation to provide any welfare benefits to current employees when they retire or retired or former employees or their survivors, dependents or beneficiaries, including but not limited to, severance, salary continuation, termination, disability, death, or retiree health or medical benefits other than continuation of welfare benefits as required by applicable law. Except as set forth on Schedule 3.29(c), none of the plans that are "employee welfare benefit plans" as defined in Section 3(1) of ERISA are self-insured or "multiple employer welfare arrangements" as defined in Section 3(40) of ERISA and there are no reserves, assets, surpluses or pre-paid premiums with respect to such plans.
- (d) Full payment has been made of all amounts other than routine claims for benefits which the Company is required to pay under the terms of any Plan, or such amounts have been properly accrued in accordance with and to the extent required by generally accepted accounting principles. There are no funded benefit obligations for which contributions have not been made or properly accrued and there are no unfunded benefit obligations that have not been accounted for by reserves, or otherwise properly footnoted in accordance with generally accepted accounting principals on the financial statements of the Company or a Subsidiary.
- (e) Each of the Plans is and has been operated and administered in all material respects in

accordance with applicable laws, including but not limited to, ERISA and the Code, and all required material governmental filings and material participant disclosures have been made on a timely basis. Each Plan subject to Section 401(a) or 403(a) of the Code has received a post Tax Reform Act of 1986 favorable determination from the Internal Revenue Service that the Plan satisfies the requirements of Section 401(a) or 403(a) of the Code, as applicable, and that the related trust is exempt from taxation under Section 501(a) of the Code, and to the knowledge of the Company and Sellers, no facts exist which could reasonably be expected to adversely affect the tax-qualified status of any such Plan. There have been no “prohibited transactions” within the meaning of Section 406 of ERISA or Section 4975 of the Code, or any breach of fiduciary duty under Title I of ERISA have occurred with respect to any of the Plans or with respect to the Sellers or the Company.

- (f) There are no pending, or to the knowledge of Sellers or the Company, threatened or anticipated claims, litigation, administrative actions or proceedings against or otherwise involving any of the Plans or related trusts, or, to the knowledge of the Company, any fiduciary thereof, by any governmental agency, or by any employee, former employee, retiree or sales personnel or by any participant or beneficiary covered under any of the Plans, or otherwise involving the Plans (other than routine claims for benefits). There is no judgment, decree, injunction, rule or order of any court, governmental body, commission, agency or arbitrator outstanding against or in favor of any Plan or, to the knowledge of the Company or Sellers, any fiduciary thereof in that capacity.
- (g) Each Plan that is a “group health plan” (as defined in Section 607(1) of ERISA) has been operated in compliance in all material respects with the provisions of COBRA (Section 4980B of the Code), the Health Insurance Portability and Accountability Act of 1996 and any applicable state laws. Except as set forth on Schedule 3.29(g), the Seller is not the sponsor of, or a participating employer in, any Plan that is an “employee welfare benefit plan” within the meaning of Section 3(1) of ERISA that does not have an underlying insurance contract. Except as set forth on Schedule 3.29(g), there are no reserves, assets, surpluses or prepaid premiums with respect to any employee welfare benefit plan.
- (h) No liability will be incurred under any Plan solely as a result of the transactions contemplated by this Agreement.
- (i) Each Plan that is a pension plan that is not qualified under Section 401(a) or 403(a) of the Code is exempt from Part 2, 3 and 4 of Title I of ERISA as an unfunded plan that is maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees pursuant to ERISA. No assets of the Company are allocated to or held in a “rabbi trust” or similar funding vehicle.

3.30. Other Countries’ Employee Benefits. With respect to the Company’s Subsidiaries and Employees located in countries other than the United States:

- (a) Except as set forth on Schedule 3.30(a), neither the Company or any Subsidiary has any agreement, arrangement, scheme, plan or obligation (whether legal or moral) that provides for the payment of any pensions, allowances, lump sums or other like benefits on retirement or on death or during periods of sickness or disablement for the benefit of any of the directors or employees of the Company or any of its Subsidiaries or former officers or employees of the Company or any of its Subsidiaries or for the benefit of the dependants of such persons nor has the Company or any of its Subsidiaries represented to any director or employee that any such arrangement may hereafter be operated for the benefit of any persons.
- (b) The Company and its Subsidiaries have complied with their respective obligations applicable in each jurisdiction with respect to national insurance or retirement income legislation including, without limitation, making all payments due in respect of those obligations and deducting and accounting for all payments or contributions due from any other person.
- (c) Neither the Company or its Subsidiaries have in existence any scheme, plan or arrangement, nor is it proposing to introduce and has not undertaken to introduce such scheme, plan or arrangement:
- (i) providing for any stock based incentives or compensation, profit sharing incentives or compensation, or profit related pay for any of its directors, officers or employees; or
 - (ii) under which any director, officer or employee of the Company or any of its Subsidiaries is entitled to a commission or remuneration of any other sort calculated by reference to the whole or part of the turnover, profits or sales of the Company.
- (d) Except to the extent to which provision or allowance has been made in the accounts or Financial Statements of the Company:
- (i) no payments have been or will have been made or promised by the Company or its Subsidiaries (whether or not pursuant to any legally binding obligation) in connection with the actual or proposed termination or suspension of employment or variation of any contract of employment of any present or former director or employee; and
 - (ii) neither the Company or its Subsidiaries have made or agreed to make any payment to or provided or agreed to provide any benefit for any present or former director or former employee or any dependant of any such director, former director or former employee.
- (e) There is no agreement or arrangement between the Company or any of its Subsidiaries and any of their respective employees or officers or former employees or officers with respect to his employment, his ceasing to be employed or his retirement which is not included in the written terms of his employment or previous employment.

3.31. Related-Party Transactions. Except as disclosed in Schedule 3.31, the Company is not party to any contract, agreement, license, lease, or arrangement with, or any other commitment to, directly or indirectly, (1) the Sellers; (2) any officer or salaried employee of the Company; (3) any corporation, trust, or other entity in which Sellers or any such officer or salaried employee has a material equity or participating interest; or (4) any partnership in which Sellers or any such officer or salaried employee has a partnership or participating interest, in each case, relating to or involving the Business, except, in each instance, for existing compensation arrangements listed in Schedules 3.19(a) and 3.19(b). Each contract, agreement, license, lease, arrangement, and commitment listed in Schedule 3.31 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.

3.32. Disclosure. No representation or warranty by the Company or Sellers in this Agreement and no statement contained herein or in any document (including, but not limited to, financial statements, exhibits and schedules), certificate, or other writing furnished or to be furnished by the Company or Sellers to the Buyers pursuant to the provisions hereof or in connection with the transactions contemplated hereby contains any untrue statement of material fact or omits or will omit to state any material fact necessary in order to make the statements herein or therein not misleading.

3.33. Brokers. Neither the Company nor Sellers have retained any broker, finder or agent or incurred any liability or obligation for any brokerage fees, commissions or finders fees with respect to this Agreement or the transactions contemplated hereby.

3.34. Shutdown Expenses. Schedule 1.3 is a complete and accurate list of Shutdown Expenses and amounts paid as of the date hereof, which shall be updated by the Sellers on the Auburn Closing Date.

3.35. Rebates and Credits. With respect to the Cahersiveen facility of the Irish Subsidiary, Sellers have taken all necessary action to ensure that the Credits will be realized to the Company or its Subsidiaries in the amounts reflected on Schedule 1.3.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF BUYER

Each of the Buyers hereby, jointly and severally, represents and warrants to the Sellers as of the date hereof, and as of the Auburn Closing Date, as set forth below.

4.1. Authority. Each of the Buyers has full right, power and authority, without the consent of any other person, to execute and deliver this Agreement and the Related Documents and to carry out the transactions contemplated hereby and thereby. All corporate and other acts or proceedings required to be taken by Buyers to authorize the execution, delivery and performance of this Agreement and the Related Documents and all transactions contemplated hereby and thereby have been duly and properly taken.

4.2. Validity. This Agreement has been, and the Related Documents to be delivered at Auburn Closing will be, duly executed and delivered by Buyers and constitute

lawful, valid and legally binding obligations of Buyers, enforceable in accordance with their respective terms. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not result in the creation of any lien, charge or encumbrance or the acceleration of any indebtedness or other obligation of Buyers and are not prohibited by, do not violate or conflict with any provision of, and do not result in a default under or a breach of (a) the articles of incorporation or by-laws of Buyers, (b) any contract, agreement, permit, license or other instrument to which each Buyer is a party or by which it is bound, (c) any order, writ, injunction, decree or judgment of any court or governmental agency, or (d) any law, rule or regulation applicable to each Buyer. No approval, authorization, consent or other order or action of or filing with any court, administrative agency or other governmental authority is required for the execution and delivery by Buyers of this Agreement or the consummation by each Buyer of the transactions contemplated hereby.

4.3. Due Organization. Delta is a corporation duly organized, validly existing and in good standing under the laws of Israel. Delta Holland is a corporation duly organized, validly existing and in good standing under the laws of the Netherlands. Delta USA is a corporation duly organized, validly existing and in good standing under the laws of Delaware, with full power and authority and all requisite licenses, permits and franchises to own, lease and operate its assets and to carry on the business in which it is engaged.

4.4. Brokers. None of the Buyers have retained any broker or finder or incurred any liability or obligation for any brokerage fees, commissions or finders fees with respect to this Agreement or the transactions contemplated hereby.

ARTICLE V

COVENANTS OF THE COMPANY AND SELLERS

Each of the Company, the Subsidiaries and Sellers hereby, jointly and severally, agrees to keep, perform and fully discharge the following covenants and agreements:

5.1 Tax Matters.

(a) **Tax Indemnification.** The Company and the Sellers shall indemnify the Company, the Subsidiaries, and Buyers, and hold them harmless from and against, without duplication, any loss, claim, liability, expense, or other damage attributable to (i) all Taxes (or the non-payment thereof) of each of the Company and the Subsidiaries for all Taxable Periods ending on or before the Auburn Closing Date (“Pre-Closing Tax Periods”) and the portion of Taxes for all Taxable Periods that include (but does not end on) the Auburn Closing Date (“Pre-Closing Straddle Periods”) to the extent such Taxes are allocable to the portion of such period occurring on or before the Auburn Closing Date and except for such Taxes arising from transactions by the Company, Subsidiaries and Buyer outside the ordinary course of business after the Auburn Closing on the Auburn Closing Date, (ii) any and all Taxes imposed on the Buyer (or Buyer Affiliate) pursuant to Code Section 951 (or any analogous or similar state or local law or regulation) with respect to the Subsidiaries and allocable to Pre-Closing Straddle Periods, (iii) all Taxes of any member of an affiliated, consolidated, combined or unitary group of which the Company or any of the Subsidiaries (or any predecessor of any of the foregoing) is

or was a member on or prior to the Auburn Closing Date, including pursuant to Treasury Regulation Section 1.1502-6 or any analogous or similar state, local, or foreign law or regulation, and (iv) any and all Taxes of any person (other than the Company and the Subsidiaries) imposed on the Company or any of the Subsidiaries as a transferee or successor, by contract or pursuant to any law, rule, or regulation, which Taxes relate to an event or transaction occurring before the Auburn Closing.

(b) Tax Returns. (i) Pre-Closing Tax Periods. Kellwood shall include the income of the Company (including any deferred items triggered into income by Treasury Regulation Section 1.1502-13 and any excess loss account taken into income under Treasury Regulation Section 1.1502-19), and the income of its Subsidiaries (to the extent applicable pursuant to Code Section 951 (or any analogous or similar state or local law or regulation)), on Kellwood's consolidated federal income Tax Returns for all Pre-Closing Tax Periods and for an allocable portion of all Pre-Closing Straddle Periods, and pay any federal income Taxes attributable to such income. Kellwood (at its sole cost and expense) shall duly prepare, or cause to be prepared, and file, or cause to be filed, on a timely basis, all Tax Returns required to be filed by each of the Company and the Subsidiaries with respect to any Pre-Closing Tax Period but which are not due until after the Auburn Closing Date, and all Group income and franchise Tax Returns ("Final Group Returns") which are required to include the Company's or any Subsidiary's items of income, gain, deduction, loss and credit for the Company's or any Subsidiary's Tax Period which ends on the Auburn Closing Date (the "Final Group Items"), which items shall be determined in accordance with Treasury Regulations Section 1.1502-76(b)(2)(i)(and any comparable provision of state, local or foreign Tax Laws), and not by ratable allocation under Treasury Regulations Section 1.1502-76(b)(2)(ii)(and any comparable provision of state, local or foreign Tax Law). All such Tax Returns shall be complete, true and accurate in all material respects and shall be filed on a timely basis consistent with each of the Company's, the Subsidiaries, and each Tax Relevant Person's past practice in filing its Tax Returns. Any such Tax Returns that each of the Company and the Subsidiaries are required to file shall not be filed without the Buyers first having had a reasonable opportunity to review said Tax Returns of the Company or Subsidiaries, as the case may be.

The Sellers shall be obligated to timely pay and discharge, or cause to be timely paid and discharged, and shall timely pay and discharge, or cause to be timely paid and discharged, all Taxes required to be paid by each of the Company and the Subsidiaries for all Pre-Closing Tax Periods of the Company and the Subsidiaries, except to the extent and as long as: (a) the same are being contested in good faith and by appropriate proceedings pursued diligently and in such a manner as not to cause any material adverse effect upon the condition (financial or otherwise) or operations of the Company or the Subsidiaries; and (b) each of the Company and the Subsidiaries shall have set aside on its books and financial records as of the Auburn Closing Date the amount of such contested Taxes.

If such a Tax Return must be signed on behalf of the Company or the Subsidiaries, the Buyers shall promptly cause it to be so signed.

Unless Kellwood's written consent is first obtained, the Buyers shall not take any action which would in any way alter the balance of Taxes owing or Tax refunds or credits obtainable with respect to any Pre-Closing Tax Periods.

(ii) Straddle Period. The Buyers shall duly prepare, or cause to be prepared, and file, or cause to be filed, all Tax Returns required to be filed by each of the Company and the Subsidiaries for any Taxable Period which includes but does not end on the Auburn Closing Date (a “Straddle Period”). For purposes of this Agreement, in the case of any Straddle Period, Taxes of each of the Company and the Subsidiaries (“Pre-Closing Straddle Tax Liability”) for the Pre-Closing Straddle Period shall, where possible, be computed as if such taxable period ended as of the close of business on the Auburn Closing Date. For purposes of the foregoing, any items attributable to a Straddle Period which cannot be taken into account in the manner so provided shall be allocated to the Pre-Closing Straddle Period for purposes of determining the Pre-Closing Straddle Tax Liability, pro rata, based upon the number of days in the Pre-Closing Straddle Period, as compared to the total number of days in the Straddle Period, provided that if any Straddle Period Tax is based on income, then such allocation shall be based upon the amount of net income of each of the Company or the Subsidiaries, as the case may be, during such Pre-Closing Straddle Period as compared to the total net income in the Straddle Period. For the avoidance of doubt, Taxes or items attributable to the cancellation of intercompany loans or indebtedness pursuant to Section 1.4 shall be allocated to the Pre-Closing Straddle Period. Furthermore, for the avoidance of doubt, Taxes imposed on the Buyer (or Buyer Affiliate) pursuant to Code Section 951 (or any analogous or similar state or local law or regulation) shall be allocable to the Pre-Closing Straddle Period in an amount equal to the Taxes which would be imposed on the Company pursuant to Code Section 951 (or any analogous or similar state or local law or regulation) with respect to the Subsidiaries as if the Auburn Closing Date were the last day of each Subsidiary’s taxable year (and taking into account Code Section 951(a)(2)(B)) (a “Hypothetical Tax Period”), and computed as if such Hypothetical Tax Period ended as of the close of business on the Auburn Closing Date. Unless otherwise indicated, a Pre-Closing Straddle Period shall be treated as a “Pre-Closing Tax Period” for purposes of this Agreement.

(c) Refunds. (i) Buyers agree to pay to Sellers any refund received after the Auburn Closing Date by the Company or any Subsidiary, in respect of any Taxes for which Sellers are liable under Section 5.1(a). The parties shall cooperate in order to take all necessary steps to claim any such refund. Any such refund received by a party for the account of the other party shall be paid to such party within thirty (30) days after such refund is received.

(ii) Sellers and Buyers agree that any payment made with respect to Taxes pursuant to this Section 5.1(c) shall be treated by the parties on their Tax Returns as an adjustment to the Purchase Price.

(iii) If, contrary to the intent of the parties as expressed hereof, any payment made pursuant to this Section 5.1(c) is treated as taxable income of the recipient, then the payor shall indemnify and hold harmless the recipient from any liability for Taxes attributable to the recipient of such payment. For purposes of this Section, the indemnified party will be considered to be liable for Tax in respect of any payment treated as taxable income at the highest marginal tax rate then in effect for corporations in the jurisdiction so characterizing the payment for the year such payment is considered to be earned by the indemnified party.

(d) If there is a Tax Audit adjustment relating to any Pre-Closing Tax Period and any Tax Period of the Company or Subsidiaries beginning after the Auburn Closing Date (a “Post-Closing Tax Period”) which is the result of an income or deduction timing difference, the

parties will use best efforts to minimize any potential penalties associated with any additional Tax and interest attributable to the Audit adjustment and there shall be an adjusting payment by (i) the party as to whom the liability for Taxes for which that party is responsible is decreased as a result of the adjustment to (ii) the party as to whom the liability for Taxes for which that party is responsible is increased as a result of the adjustment, such payment to be in the amount equal to the lesser of the amount of such decrease or the amount of such increase.

(e) Cooperation on Tax Matters. Each party will provide, or cause to be provided, to the other party copies of all correspondence received from any taxing authority by such party or any of its affiliates in connection with the liability of the Company or any Subsidiary for Taxes for any period for which such other party is or may be liable under paragraph (a) of Section 5.1. The parties will provide each other with such cooperation and information as they may reasonably request of each other in preparing or filing any Tax Return or claim for refund, in determining a liability or a right of refund or in conducting any audit or other proceeding in respect of Taxes imposed on the parties or their respective affiliates. The parties and their affiliates will preserve and retain all Tax Returns, schedules, work papers and all material records or other documents relating to any such Tax Returns, claims, audits or other proceedings until the later of six months after the expiration of the applicable limitations period on assessment with respect to any such Taxes, or the final resolution of all Audits or litigation initiated prior to the expiration of the applicable limitations period and shall make such documents available to the other party or any affiliate thereof, and their respective officers, employees and agents, upon reasonable notice and at reasonable times, it being understood that such representatives shall be entitled to make copies of any such books and records relating to the Subsidiary as they shall deem necessary. Any information obtained pursuant to this Section 5.1(e) shall be kept confidential, except as may be otherwise necessary in connection with the filing of Tax Returns or claims for refund or in conducting any audit or other proceeding. Each party shall provide the cooperation and information required by this 5.1(e) at its own expense.

(f) Audits. With respect to Audits relating to Pre-Closing Tax Periods (other than Pre-Closing Straddle Periods) (a “Pre-Closing Audit”) Kellwood shall control (at its expense) all proceedings and may make all decisions taken in connection therewith at Kellwood’s sole discretion, provided that any such proceeding and any such decision taken in connection therewith does not increase the Tax liability for any Straddle Period or any Post-Closing Tax Period. Otherwise, no such decision shall be implemented or effectuated without the prior written consent of the Buyers (which consent shall not be unreasonably withheld or delayed). Kellwood shall keep the Buyers fully apprised of all aspects of any such Pre-Closing Audit with respect to each of the Company and the Subsidiaries. With respect to any such Pre-Closing Audit, the Buyers shall cause the Company and Subsidiaries to cooperate fully with Sellers and their counsel and to furnish Kellwood with the usual form of power of attorney (IRS Form 2848) and provide to Kellwood such records and information as may be necessary for Kellwood to control such Pre-Closing Audit proceeding.

(g) Tax Sharing Agreements. The Sellers shall cause all Tax allocation agreements or Tax sharing agreements with respect to the Company or the Subsidiaries to be terminated as of immediately prior to the Auburn Closing Date and shall ensure that such agreements are of no further force or effect as to the Company or the Subsidiaries on and after the Auburn Closing Date and there shall be no further liability of Company under any such

agreement.

(h) 338(g) Election. The Buyer shall not make an election under Section 338(g) of the Code with respect to Spainco without the consent of Kellwood (which consent shall not be unreasonably withheld).

(i) Certain Definitions. For purposes of Section 3.22 and Section 5.1, the following terms shall have the following meanings:

(i) “Audit” shall mean any audit, assessment of Taxes, any other examination or claim by any Tax Authority, judicial, administrative or other proceeding or litigation (including any appeal of any such judicial, administrative or other proceeding or litigation) relating to Taxes and/or Tax Returns.

(ii) “Final Group Items” shall have the meaning set forth in Section 5.1(b).

(iii) “Final Group Returns” shall have the meaning set forth in Section 5.1(b).

(iv) “Group” shall mean, for federal income tax purposes, the Company and all of the other members of the affiliated group of corporations that files consolidated returns under Section 1501 et. seq. of the Code and the Treasury Regulations thereunder in which Kellwood is the common parent, and, for all other jurisdictions, the Company and all those other members that comprise a unitary, consolidated or combined group of corporations in which Kellwood is the common parent (or has such similar role).

(v) “Pre-Closing Audit” shall have the meaning set forth in Section 5.1(d).

(vi) “Pre-Closing Tax Period” shall have the meaning set forth in Section 5.1(b).

(vii) “Pre-Closing Straddle Period” shall have the meaning set forth in Section 5.1(a).

(viii) “Pre-Closing Straddle Tax Liability” shall have the meaning set forth in Section 5.1(b).

(ix) “Post-Closing Tax Period” shall have the meaning set forth in Section 5.1(b).

(x) “Tax” shall mean any federal, territorial, state, local, or foreign income, gross receipts, license, payroll, wage, employment, excise, utility, communications, production, occupancy, severance, stamp, occupation, premium, windfall profits, environmental, customs duties, capital stock, capital levy, franchise, profits, withholding, social security (or similar), unemployment,

disability, real property, real property gains, recordation, business license, workers' compensation, Pension Benefit Guaranty Corporation, personal property, sales, use, transfer, registration, value added, ad valorem, alternative or add-on minimum, estimated, or other tax, fee, charge, premium, imposition of any kind whatsoever, however denominated, imposed by any Tax Authority, together with any interest, penalties or other additions to tax and any interest on any such interest, penalties and additions to tax that may become payable in respect thereof.

(xi) "Tax Authority" shall mean the Internal Revenue Service ("IRS") and any other federal, territorial, state, local or foreign government and any agency, authority or political subdivision of any of the foregoing.

(xii) "Tax Laws" shall mean the Code, federal, territorial, state, county, local or foreign laws, rules, regulations, pronouncements, rulings, notice, revenue procedures, etc. related to Taxes.

(xiii) "Tax Relevant Person" shall mean, individually and collectively, any Person as to which the Company is or may be liable for the Taxes of any such other Person either by reason of Treasury Regulations Section 1.1502-6 (or any successor provision or comparable provision under any other Tax Law), as a successor or transferee, by contract, indemnity or, otherwise pursuant to any other Tax Law.

(xiv) "Tax Returns" shall mean reports, estimates, declarations of estimated tax, information statements and returns relating to, or required to be filed in connection with, any Taxes, including information returns or reports with respect to backup withholding and other payments to third parties.

(xv) "Taxable Period" means any taxable year or any other period that is treated as a taxable year with respect to which any Tax may be imposed under any applicable statute, rule or regulation.

5.2 Further Assurances. After the Auburn Closing, at the request of the Buyers and without further conditions or consideration, Sellers shall execute and deliver from time to time such other instruments of conveyance and transfer and take such other actions as the Buyers may reasonably request in order to more effectively consummate the transactions contemplated hereby and to vest in Delta USA all right, title and interest in and to all of the Stock and to vest in Delta Holland all right, title and interest in and to all of the Irish Stock and with respect to the Tralee facility of the Irish Subsidiary, to ensure that the Credits will be realized to the Company or its Subsidiaries in the amounts reflected on Schedule 1.3.

5.3 Interim Conduct of Business. Except for actions taken by Sellers to close the Irish operations, the Subsidiaries and Sellers hereby, jointly and severally, covenant and agree, from the date hereof through the Auburn Closing Date, that the Business will be conducted only in the ordinary course and, except as may be permitted by this Agreement, or as otherwise shown on Schedule 5.3 or approved in writing in advance by the Buyers (including, without limitation, the discontinuance, restructuring or shutdown of operations of the Company or any Subsidiaries),

and the Company, the Subsidiaries and Sellers agree as follows:

- (a) to maintain inventories of the Business at current levels, except for sales in the ordinary course of business;
- (b) to maintain the assets and properties of the Business in good repair, order and condition, reasonable wear and tear excepted;
- (c) to maintain and keep in full force and effect all insurance on assets and property or for the benefit of employees of the Business, all liability and other casualty insurance, and all bonds on personnel, presently carried;
- (d) to preserve intact the organization and reputation of the Business and to keep available the services of the present executives, employees and agents of the Business and to preserve the good will of suppliers, customers and others having business relationships with the Business;
- (e) to maintain books, accounts and records of the Business in the usual, regular and ordinary manner on a basis consistent with past practices;
- (f) to file all Tax Returns of the Company and its Subsidiaries and amendments thereto required to be filed by it or them (subject to any applicable extensions) and pay all Taxes shown as due and payable thereon. All returns and reports in respect of employee withholdings, FICA, unemployment and other similar items and other applicable taxes shall be timely made as shall all deposits and payments due in respect of such taxes and obligations.
- (g) not enter into, amend or terminate any employment, bonus, severance or retirement contract or arrangement, nor increase by more than 5% any salary or other form of compensation payable or to become payable to any executives or employees of the Business;
- (h) not make any loan or advance to any of the Company's or the Subsidiaries' officers, directors, consultants, agents or Employees or to any member of their families or pay, loan or advance any amount to any third party, otherwise than in the ordinary course of business;
- (i) not pay any pension, retirement allowance or material employee benefit not required by any plan, policy or program identified on Schedule 3.29, or adopt, agree to adopt, or make

any announcement regarding the adoption of (i) any new pension, retirement or other employee benefit plan, policy or program or (ii) any amendments to any existing plan, policy or program identified on Schedule 3.29 unless required by applicable law or other than in the ordinary course of business;

(j) not enter into, amend or terminate, or agree to enter into, amend or terminate, any Material Contract;

(k) not extend credit in the sale of products, collection of receivables or otherwise, other than in the ordinary and regular course of business;

(l) not declare, set aside or pay any dividend or make any other distribution with respect to the capital stock of the Company;

(m) not merge or consolidate with or agree to merge or consolidate with, nor purchase or agree to purchase all or substantially all of the assets of, nor otherwise acquire, any corporation, partnership, or other business organization or division thereof;

(n) not sell, lease or otherwise dispose of or agree to sell, lease or otherwise dispose of, any of the assets, properties, rights or claims of the Business, except in the ordinary course of business;

(o) not authorize for issuance, issue, sell or deliver any additional shares of the Company's capital stock of any class or any securities or obligations convertible into shares of the Company's capital stock of any class or issue or grant any option, warrant or other right to purchase any shares of the Company's capital stock of any class;

(p) not take any action not previously announced to the trade, including providing promotions, coupons, discount or price increases, other than in the ordinary course of business;

(q) not incur or become subject to, nor agree to incur or become subject to, any debt, obligation or liability, contingent or otherwise, except current liabilities and contractual obligations in the ordinary course of business;

(r) not make any single capital expenditure or future commitment in excess of \$20,000 for additions to property, plant, equipment or intangible capital assets or make aggregate capital expenditures or future commitments in excess of

\$50,000 for additions to property, plant, equipment or intangible capital assets;

(s) not change any of the Company's or any of its Subsidiaries' banking or safe deposit arrangements;

(t) not sell, transfer or lease, or grant any security interest in, any properties or assets of the Business, other than in the ordinary course of business;

(u) grant or extend any power of attorney or act as guarantor, surety, co-signer, endorser, co-maker, indemnitor or otherwise in respect of the obligation of any Person, except in the ordinary course of business;

(v) not propose or adopt any amendments to the Certificate of Incorporation or by-laws of the Company, or other organizational documents of any of its Subsidiaries;

(w) not take any action to seek, encourage, solicit or support any inquiry, proposal, expression of interest or offer from any other person or entity with respect to an acquisition, combination or similar transaction involving the Business or substantially all of the assets or securities related thereto, and the Stockholder will promptly inform Buyers of the existence of any such inquiry, proposal, expression of interest or offer and shall not without the consent of Buyers furnish any information to or participate in any discussions or negotiations with any other person or entity regarding the same; or

(x) not agree, whether in writing or otherwise, to do any of the foregoing.

5.6 Shutdown of Irish Facilities. From the date hereof until the Closing Date, the Sellers and the Company shall notify Buyers of the anticipated nature and amount of the Shutdown Expenses prior to incurrence. At least three (3) days prior to the Auburn Closing, Sellers shall deliver to Buyers a detailed pro forma statement of the aggregate Shutdown Expenses as of the Auburn Closing Date, which shall be subject to Buyers' approval.

5.7 Access. From the date hereof through the Auburn Closing Date, Sellers shall cause the Company and each Subsidiary to give Delta USA and its representatives reasonable access (including in connection with verification of the Shutdown Expenses) to all properties, facilities, personnel, books, contracts, leases, commitments and records, and during this period Sellers shall cause the Company and each Subsidiary to furnish Buyers with all financial and operating data and other information as to the Business and its assets, properties, rights and claims, as Buyers may from time to time request. In particular, Sellers shall cause the Company and each Subsidiary to (a) afford to the officers, employees, attorneys, accountants, appraisers, environmental engineers and other authorized representatives of Delta USA reasonable access,

during normal business hours, to the offices, plants, properties, books and records of the Company and each Subsidiary in order that Buyers may have full opportunity to make such engineering, environmental, legal, financial, accounting and other reviews or investigations of the Business and the Company's and each Subsidiary's assets as Buyers shall desire to make, (b) use its best efforts to cause its independent public accountants to permit Delta USA's independent public accountants to inspect their work papers and other records relating to the Business and the its assets, and (c) furnish, and cause the officers and employees of the Company and each Subsidiary to furnish, to Delta USA and its authorized representatives all additional financial and operating data and other information regarding their assets, properties, rights, claims, contracts and business as Buyers shall from time to time reasonably request. All of such access and disclosures will be pursuant to the confidentiality covenants currently existing between the parties, the terms of which are incorporated herein by reference.

5.8 Continued Assistance. After the Auburn Closing, Sellers shall cooperate in an orderly transfer of the Business and the continuation thereof by Delta USA. From time to time, at Buyers' request and without further consideration, Sellers shall execute, acknowledge and deliver such documents, instruments or assurances and take such other action as Buyers may reasonably request to vest in Delta USA all right, title and interest in and to all of the Stock or more effectively assign, convey and transfer any of the assets, properties, rights or claims of the Business and will assist Delta USA in the vesting, collection or reduction to possession of such assets, properties, rights and claims.

5.9 Other Consents.

(a) Sellers shall use, and shall cause the Company and its Subsidiaries to use commercially reasonable efforts to obtain at the earliest practicable date and in any event before the Auburn Closing all other consents, governmental authorizations, approvals, estoppel certificates and filings required to be obtained by them or which may be reasonably necessary to the consummation of the transactions contemplated by this Agreement or which are reasonably requested by Buyers.

(b) On or prior to the Auburn Closing Date, Sellers shall obtain, and shall cause the Company to obtain all such waivers and consents under any indenture, loan agreement or security agreement to which the Company or any Subsidiary is a party as are necessary to prevent a breach or violation of, or default under, any such indenture, loan agreement or security agreement as a result of the consummation of the transactions contemplated hereby.

5.10 Efforts. Each of the Sellers shall use its commercially reasonable efforts to consummate the transactions contemplated by this Agreement and shall not take any other action inconsistent with its obligations hereunder or which could hinder or delay the consummation of the transactions contemplated hereby. From the date hereof through the Auburn Closing Date, each of the Sellers shall use its commercially reasonable efforts to fulfill the conditions to its own and any Subsidiary's obligations hereunder and to cause its representations and warranties to remain true and correct in all material respects as of the Auburn Closing Date.

ARTICLE VI

COVENANTS OF BUYER

Each Buyer hereby, jointly and severally, agrees to keep, perform and fully discharge the following covenants and agreements.

6.1. Records and Documents. For three (3) years following the Auburn Closing Date (or if later to the extent requested in connection with any Tax Audit), Buyers shall cause the Company to grant to Sellers, and their representatives, at Sellers' request, access to and the right to make copies of those records and documents, possession of which is transferred to Buyers, as may be necessary or useful in connection with the Sellers' Tax filings after the Auburn Closing.

6.2. Other Consents. Each Buyer shall use its commercially reasonable efforts to obtain or make at the earliest practicable date and in any event before the Auburn Closing all other consents, governmental authorizations, approvals, estoppel certificates and filings required to be obtained by it or which may be reasonably necessary to the consummation of the transactions contemplated by this Agreement or which are reasonably requested by the Company.

6.3. Efforts. Each Buyer shall use its commercially reasonable efforts to consummate the transactions contemplated by this Agreement and shall not take any other action inconsistent with its obligations hereunder or which could hinder or delay the consummation of the transactions contemplated hereby. From the date hereof through the Auburn Closing Date, each Buyer shall use its commercially reasonable efforts to fulfill the conditions to its own obligations hereunder and to cause its representations and warranties to remain true and correct in all material respects as of the Auburn Closing Date.

ARTICLE VII

CONDITIONS PRECEDENT TO OBLIGATIONS OF BUYERS

Each and all of the obligations of Buyers to consummate the transactions contemplated by this Agreement are subject to fulfillment prior to or at the Auburn Closing of the following conditions, except to the extent that Buyers may waive any one or more thereof:

7.1. Accuracy of Warranties and Performance of Covenants. The representations and warranties of Sellers and the Company contained herein, the Schedules hereto and in all certificates and other documents delivered or to be delivered by Sellers or the Company pursuant hereto shall be true, complete and accurate in all material respects as of the date when made and at and as of the Auburn Closing Date as though such representations and warranties were made at and as of such date, except for representations and warranties that speak as of a specific date or time, which need only be true and correct as of such date or time. Sellers and the Company shall have performed all of the obligations and complied in all material respects with all of the covenants, agreements and conditions required to be performed or complied with on or prior to the Auburn Closing.

7.2. No Pending Action. No action, suit, proceeding or investigation before any court, administrative agency or other governmental authority shall be pending or threatened against the Company wherein an unfavorable judgment, decree or order would prevent the carrying out of this Agreement or any of the material transactions contemplated hereby, declare unlawful the transactions contemplated hereby, cause such transactions to be rescinded, or which would materially affect the right of the Company to own, operate or control the Business or its assets.

7.3. Regulatory Approvals. All regulatory agencies shall have taken such action as may be required to permit the consummation of the transactions contemplated hereby and such actions shall remain in full force and effect and shall be reasonably satisfactory in form and substance to Buyers and its counsel, including without limitation the expiration or termination of all applicable waiting periods under foreign antitrust laws.

7.4. Consents. The Company shall have received in writing any and all consents, approvals, authorizations, exemptions or waivers set forth on Schedule 3.3 hereto.

7.5. Closing Deliveries. Sellers shall have delivered to Buyers, or cause to be delivered to Buyers, the other items required to be delivered to Buyers in accordance with Section 2.3 hereof.

7.6. Compliance. Sellers and the Company shall have furnished Buyers with such certificates to evidence compliance with the conditions set forth in this Article VII as are required to be complied with prior to Auburn Closing.

ARTICLE VIII

CONDITIONS PRECEDENT TO OBLIGATIONS OF SELLERS

Each and all of the obligations of Sellers to consummate the transactions contemplated by this Agreement are subject to fulfillment prior to or at the Auburn Closing of the following conditions, except to the extent that Sellers may waive any one or more thereof:

8.1. Accuracy of Warranties and Performance of Covenants. The representations and warranties of the Buyers contained herein shall be true, complete and accurate in all material respects as of the date when made and at and as of the Auburn Closing Date as though such representations and warranties were made at and as of such date, except for representations and warranties that speak as of a specific date or time, which need only be true and correct as of such date or time. The Buyers shall have performed all of the obligations and complied in all material respects with all of the covenants, agreements and conditions required to be performed or complied with on or prior to the Auburn Closing.

8.2. No Pending Action. No action, suit, proceeding or investigation before any court, administrative agency or other governmental authority shall be pending or threatened against the Buyers wherein an unfavorable judgment, decree or order would prevent the carrying out of this Agreement or any of the transactions contemplated hereby, declare unlawful the transactions contemplated hereby or cause such transactions to be rescinded.

8.3. Regulatory Approvals. All regulatory agencies shall have taken such action as may be required to permit the consummation of the transactions contemplated hereby and such actions shall remain in full force and effect and shall be reasonably satisfactory in form and substance to the Sellers and their counsel, including without limitation the expiration or termination of all applicable waiting periods under and foreign antitrust laws.

8.4. Letter of Credit. Buyers shall have delivered a Letter of Credit in the amount of One Million Five Hundred Thousand Dollars (\$1,500,000) issued by a bank and on terms reasonably acceptable to Sellers to partially secure the indemnification obligation in Section 10.2(e) but only with respect to Guarantees related to the Irish Subsidiary.

ARTICLE IX

TERMINATION BY THE PARTIES

9.1. Termination. Without prejudice to other remedies which may be available to the parties by law or under this Agreement, this Agreement may be terminated and the transactions contemplated hereby may be abandoned:

(a) by mutual consent of Buyers and Sellers;

(b) by Buyers if there has been a material misrepresentation, material breach of warranty or material breach of a covenant by Sellers in the representations and warranties or covenants set forth in this Agreement, the Related Documents or the Schedules and Exhibits attached hereto, which has not been cured within 20 days after written notification thereof by the Buyers to Sellers;

(c) by Sellers if there has been a material misrepresentation, material breach of warranty or material breach of a covenant by the Buyers in the representations and warranties or covenants set forth in this Agreement, the Related Documents or the Schedules and Exhibits attached hereto, which in the case of any breach of covenant has not been cured within 20 days after written notification thereof by Sellers to the Buyers;

(d) by either Buyers or Sellers by giving written notice of such termination on the Auburn Closing Date to the other (the “**Notified Party**”) if, as of the Auburn Closing Date, any condition precedent to the performance of the obligations of the party giving such notice shall not have been satisfied and shall not have been waived by such party; provided, however, that the Notified Party shall be allowed twenty (20) days within which to satisfy any such unsatisfied condition precedent; and

provided, further, so long as the party giving such notice shall not be in material default hereunder; or

(e) by either Buyers or Sellers by notice to the other, if the Auburn Closing shall not have been consummated on or before November 14, 2003, unless extended by written agreement of the parties hereto.

9.2. Effect of Termination Without Default. If this Agreement is terminated pursuant to Section 9.1 hereof, without any breach or default under this Agreement by a party all further obligations of the parties hereto shall cease and terminate without liability of any party hereto to another party hereto.

9.3. Failure to Close Because of Default. In the event that this Agreement is terminated pursuant to Section 9.1 by reason of a breach or default of a representation, warranty or covenant under this Agreement, the Related Documents or the Schedules and Exhibits attached hereto, the parties shall have and retain all of the rights afforded them at law or in equity by reason of that breach or default, and the provisions set forth in this Section 9.3 shall survive such termination.

9.4. No Publicity. Neither the Company, Sellers nor the Buyers shall make or issue, or cause to be made or issued, any announcement or written statement concerning termination of this Agreement or the transactions contemplated hereby for dissemination to the general public without the prior written consent of the other party except as required by law (including applicable federal and foreign securities laws) or legal process.

ARTICLE X

SURVIVAL AND INDEMNIFICATION

10.1. Survival. All representations and warranties contained in this Agreement or in each of the Related Documents delivered pursuant hereto, shall survive the Auburn Closing hereunder and any investigation heretofore made by or on behalf of any party, and shall be fully effective and enforceable for a period of two (2) years following the Auburn Closing Date (unless a different period is specifically assigned thereto), but shall thereafter be of no further force or effect, except as they relate to claims alleging fraud on the part of a party hereto. Any claim for indemnification pursuant to this Article X asserted in writing before the second anniversary of the Auburn Closing Date or other applicable survival period shall survive until resolved or judicially determined. Notwithstanding the foregoing, any representations or warranties regarding Sections 3.1 (“Authority”), 3.2 (“Validity”), 3.4 (“Capital Stock”), 3.5 (“Due Organization”), 3.15 (“Real Estate”), 3.22 (“Taxes”), 3.39 (“United States Employee Benefits”) or 3.30 (“Other Countries’ Employee Benefits”), and Sellers’ and Company’s indemnification obligations with respect thereto shall survive for thirty (30) days after the expiration of the statute of limitations period applicable thereto. Notwithstanding the foregoing, any representations or warranties regarding Section 3.26 (“Environmental Matters”) shall survive for five (5) years.

10.2. Indemnification.

(a) Subject to the terms and conditions of this Article X, each of Buyers, jointly and severally, on the one hand, and Sellers, jointly and severally, on the other, covenant and agree to indemnify and hold harmless the other and their respective Affiliates (including any successor or assign, officer, director, shareholder, partner, member, employee, agent or representative of any thereof, as the case may be) from and against 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, "**Damages**") (together with interest at a floating interest rate equal at all times to the rate of interest published from time to time by Bank of America as the "**Prime Rate**" from the date upon which the Damages were incurred to the date of payment) with respect to, related to, caused by or arising from any misrepresentation, breach of warranty or failure to fulfill any covenant or agreement of, such Indemnitor contained in or made pursuant to this Agreement, Schedule or Related Document.

(b) Sellers, jointly and severally, covenant and agree to indemnify and hold harmless Buyer and its Affiliates from and against any Environmental Liabilities incurred by Buyer relating to violations of Environmental Laws or Releases of Hazardous Substances occurring prior to the Closing from or onto (i) any property presently or formerly owned, leased or managed by the Company, any Subsidiary or a predecessor in interest, or (ii) any facility which received Hazardous Substances generated by the Company, any Subsidiary or a predecessor in interest including but without limitation, those conditions referenced in the Phase I Environmental Studies prepared for the Company's facilities in Adairville and Auburn, Kentucky, provided, however, that Sellers shall have no obligation to indemnify or reimburse Buyer and its Affiliates for the Remedial Actions identified on Schedule 1.3 under the headings entitled "Environmental Decommissioning," "IPC License" and "Environmental Contingency (Oil Spill)" unless, and only to the extent that, such Remedial Actions exceed the aggregate of the specific dollar amounts specified therein (i.e., \$466,000) plus an allowable increase up of up to 20% of such amount for documented, unanticipated costs and expenses associated therewith (the "**Remedial Action Indemnification Exception Amount**"). For avoidance of doubt, in no event shall the Remedial Action Indemnification Exception Amount exceed \$559,200.

(c)) Sellers, jointly and severally, covenant and agree to indemnify and hold harmless Buyer and its Affiliates from and against any claim or allowance in the form of a rebate, credit or otherwise by Walmart or its affiliates in respect of sales by the Company or any of its Subsidiaries to Walmart or its affiliates prior to the Auburn Closing.

(d) Sellers, jointly and severally, covenant and agree to indemnify and hold harmless Buyer and its Affiliates and the Company, from and against any claims, contributions or other liabilities that are controlled group liabilities under ERISA and related laws that are imposed upon the Company as a result of the Company's status as a member of any Seller's controlled group.

(e) Kellwood and its affiliate, Gerber Childrenswear, Inc. have made certain guarantees on behalf of the Company and its Subsidiaries, as set forth on Schedule 10.2 (d) (the “**Guarantees**”). Buyers, jointly and severally, covenant and agree to indemnify and hold harmless Sellers and their Affiliates from and against any and all liability of Sellers related to each Guaranty.

10.3. Notice of Claims. Any party seeking indemnification (the “**Indemnified Party**”) shall give prompt written notice to the indemnifying party (the “**Indemnitor**”) of the facts and circumstances giving rise to the claim (the “**Notice**”) for which such indemnified party intends to assert a right to indemnification under this Agreement (collectively, “**Claims**”). Failure to give such notice shall not relieve the Indemnitor of any obligations which the Indemnitor may have to the Indemnified Party under this Article X, except to the extent that such failure has prejudiced the Indemnitor under the provisions for indemnification contained in this Agreement. The Indemnitor shall reimburse an Indemnified Party promptly after delivery of a Notice certifying that the Indemnified Party has incurred Damages after compliance with the terms of this Article X; provided, however, the party receiving the Notice shall have the option to contest any such Damages or its obligations to indemnify therefor in accordance with the terms of this Agreement, at such party’s own cost and expense. Such option shall be exercised by the giving of notice by the exercising party to the other party within twenty (20) days of receipt of a Notice.

10.4. Conditions of Indemnification of Third-Party Claims. The obligations and liabilities of an Indemnitor under Section 10.3 hereof with respect to Damages resulting from Claims by persons not party to this Agreement shall be subject to the following terms and conditions:

(a) Promptly after delivery of a Notice in respect of a Claim and subject to paragraph (c) of this Section 10.4, the Indemnitor may elect, by written notice to the Indemnified Party, to undertake the defense thereof with counsel reasonably satisfactory to the Indemnified Party, at the sole cost and expense of the Indemnitor. If the Indemnitor chooses to defend any claim, the Indemnified Party shall cooperate with all reasonable requests of the Indemnitor and shall make available to the Indemnitor any books, records or other documents within its control that are necessary or appropriate for such defense.

(b) In the event that the Indemnitor, within a reasonable time after receipt of a Notice, does not so elect to defend such Claim, the Indemnified Party will have the right (upon further notice to the Indemnitor) to undertake the defense, compromise or settlement of such Claim for the account of the Indemnitor, subject to the right of the Indemnitor to assume the defense of such Claim pursuant to the terms of paragraph (a) of this Section 10.4 at any time prior to settlement, compromise or final determination thereof, provided, that the Indemnitor reimburses in full all costs of the Indemnified Party (including reasonable attorney’s fees and expenses) incurred by it in connection with such defense prior to such assumption.

(c) Anything in this Section 10.4 to the contrary notwithstanding, (i) if the Indemnitor assumes the defense of any Claim, any Indemnified Party shall be entitled to

participate in the defense, compromise or settlement of such Claim with counsel of its own choice at its own expense, (ii) no person who has undertaken to defend a Claim under Section 10.4(a) hereof shall, without written consent of the Indemnified Party, settle or compromise any Claim or consent to entry of any judgment which does not include as an unconditional term thereof the release by the claimant or the plaintiff of the Indemnified Party from all liability arising from events which allegedly give rise to such Claim.

10.5. Limitations on the Sellers' Indemnification Obligation.

(a) Notwithstanding anything to the contrary provided elsewhere in this Agreement, the obligations of any Indemnitor under this Agreement to indemnify any Indemnified Party with respect to any Claim pursuant to Section 10.2 shall be of no force and forever barred unless the Indemnified Party has given the Indemnitor notice of such claim prior to the second anniversary of the Auburn Closing Date, provided that there shall be no time limit for Claims made for a breach of the representations and warranties contained in Sections 3.1 ("Authority"), 3.2 ("Validity"), 3.4 ("Capital Stock"), 3.5 ("Due Organization"), 3.14 ("Real Estate"), 3.22 ("Taxes"), 3.29 ("United States Employee Benefits") and 3.30 ("Other Countries' Employee Benefits"). In any event, the parties shall fully cooperate with each other and their respective counsel in accordance with Section 10.4 in connection with any such litigation, defense, settlement or other attempted resolution. The obligations of any Indemnitor under this Agreement for breaches of the representations and warranties contained in Section 3.26 ("Environmental Matters") shall be barred unless notice is received prior to the fifth anniversary of the Auburn Closing Date.

(b) Sellers shall not be liable, and Buyers agree not to enforce any Claim, for indemnification under this Agreement until the aggregate amount of all such Damages for which Sellers would otherwise be required to provide indemnification for such Claims exceeds \$250,000 (the "**Threshold Amount**"), at which time the Buyers shall be entitled to recover only the amount of such Claims in excess of the Threshold Amount. Buyers shall provide Sellers with Notice of all Claims included in the Threshold Amount. In no event shall Sellers' indemnification obligation exceed the Purchase Price, as adjusted pursuant to Section 1.3(a) (the "Cap"). The Threshold Amount and the Cap shall not apply to indemnification obligations for Damages in connection with a breach of the representations, warranties and covenants contained in Sections 3.22 ("Taxes"), 3.26 ("Environmental Matters") and 5.1 ("Tax Matters") or Claims for indemnification pursuant to Sections 10.2(b), 10.2(c) and 10.2(d); provided, further, the Threshold Amount shall not apply to indemnification obligations for Damages in connection with a breach of the representations, warranties and covenants contained in Sections 3.1 ("Authority"), 3.2 ("Validity"), 3.4 ("Capital Stock") and 3.5 ("Due Organization").

10.6. Treatment of Indemnification Payments. All indemnification payments made pursuant to this Article X shall be treated by the Buyers and Sellers as an adjustment to the Purchase Price to the extent permitted by law.

10.7 Spainco. For purposes of this Article IX, Spainco's indemnification obligations as a Seller shall terminate as of the Auburn Closing.

ARTICLE XI

GENERAL PROVISIONS

11.1. Amendments and Waiver. No amendment, waiver or consent with respect to any provision of this Agreement or the Related Documents shall in any event be effective, unless the same shall be in writing and signed by the parties hereto, and then such amendment, waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. The failure of any party at any time or times to require performance of any provisions hereof shall in no manner affect that party's right at a later time to enforce the same. No waiver by any party of the breach of any term or covenant contained in this Agreement or the Related Documents in any one or more instances shall be deemed to be, or construed as, a further or continuing waiver of any such breach, or a waiver of the breach of any other term or covenant contained in this Agreement or the Related Documents. Waivers may be made in advance or after the right occurred has arisen or the breach or default waived has occurred. Any waiver may be conditional.

11.2. Notices. All notices, requests, demands, consents or waivers and other communications required or permitted hereunder shall be in writing and shall be deemed to have been duly given, if personally delivered or sent by facsimile transmission (with immediate confirmation) with confirming copy sent by overnight courier (such as Express Mail, Federal Express, etc.) and a delivery receipt obtained and addressed to the intended recipient as follows:

(a) If to Sellers:

Kellwood Company
600 Kellwood Parkway
Chesterfield, Missouri 63017-5897
Attention: Thomas H. Pollihan, Esq., General Counsel
Telecopy No.: (314) 576-3388

With a copy to:

McDermott, Will & Emery
227 West Monroe Street
Chicago, IL 60606-5096
Telecopy No.: (312) 984-7700
Attention: Robert A. Schreck, Jr., P.C.

(b) If to Buyers:

Delta Galil USA Inc.

c/o Delta Galil Industries Ltd.

Textile Building

2 Kaufman Street

Tel Aviv 68012 Israel Attention: Arnon Tiberg, President & CEO

Telecopy No.: 972-3-519-3790

With a copy to:

Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co.

One Azrieli Center, Round Building

Tel Aviv 67021 Israel

Attention: Daniel K. Gamulka, Esq.

Telecopy No.: 972-3-607-4411

And to :

Pryor Cashman Sherman & Flynn LLP

410 Park Avenue

New York, NY 10022

Attention: Kenneth Schulman, Esq.

Telecopy No.: 212-326-0806

Any party may change its address for receiving notice by written notice given to the others named above.

11.3. Expenses. Buyers shall pay up to \$500,000 of the transfer fee, if any, required by Wilson to assign or transfer the Wilson license in connection with the transaction contemplated in this Agreement. Buyers shall pay any other fees or expenses that Buyers deem reasonable and that are payable to any licensor in connection with the assignment or transfer to Buyers of any existing licenses. In no event shall Sellers be responsible for any fees or expenses payable to any licensor that arises as a result of the transaction contemplated hereunder. Except as otherwise expressly provided herein, each party to this Agreement shall pay its own costs and expenses in connection with the transactions contemplated hereby. If any action is brought by either party to enforce any provision of this Agreement, the prevailing party shall be entitled to recover court costs, arbitration expenses and reasonable attorneys' fees. The provisions of this Section 11.3 shall survive any termination of this Agreement.

11.4. Counterparts. This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

11.5. Successors and Assigns. This Agreement shall bind and inure to the benefit of the parties named herein and their respective heirs, successors and permitted assigns. This Agreement shall not be assigned by Sellers or the Company without the express prior written consent of the Buyers and any attempted assignment, without such consent, shall be null and

void. The Buyers may assign all or part of this Agreement and its rights and benefits hereunder (a) to a Buyer Affiliate or (b) from and after the Auburn Closing to a person, not a party to this Agreement, who assumes all of the obligations of the Buyers hereunder, provided in each such case that no such assignment shall release the Buyers from its duties and obligations hereunder. This Agreement does not create any rights, claims or benefits inuring to any person that is not a party hereto nor create or establish any third-party beneficiary hereto.

11.6. Entire Transaction. This Agreement and the documents referred to herein contain the entire understanding among the parties with respect to the transactions contemplated hereby and supersedes all other agreements, understandings and undertakings among the parties on the subject matter hereof; provided, however, that the provisions contained in the Confidentiality Agreement dated February 28, 2003, shall survive any termination of this Agreement and shall remain in full force and effect until the Auburn Closing contemplated hereby is consummated. All exhibits and schedules hereto are hereby incorporated by reference and made a part of this Agreement.

11.7. Applicable Law.

(a) The parties acknowledge and agree that this Agreement constitutes a contract pertaining to a transaction covering in the aggregate not less than \$1,000,000 and that their choice of law and choice of jurisdiction specified below have been made pursuant to and in accordance with Sections 5-1401 and 5-1402, respectively, of the New York General Obligations Law. Accordingly, the parties acknowledge and agree that this Agreement shall be governed by the laws of the State of New York, as to all matters including, but not limited to, matters of validity, construction, effect, performance and liability, without consideration of conflicts of laws provisions contained therein, and the courts of the State of New York have exclusive jurisdiction of all disputes with respect to an alleged breach of any representation, warranty, agreement or covenant of this Agreement, including, but not limited to, any dispute relating to the construction or interpretation of the rights and obligations of any party, which is not resolved through discussion between the parties.

(b) The parties hereby irrevocably and unconditionally submit to the exclusive jurisdiction of any New York State or Federal court sitting in New York County in any action or proceeding commenced by the Buyer or to which the Buyer is a party arising out of or relating to this Agreement, any Related Document or any transaction contemplated hereby or thereby. Sellers and the Company hereby irrevocably waive, to the fullest extent it or they may effectively do so, the defense of an inconvenient forum to the maintenance of such action or proceeding. Sellers and the Company also irrevocably and unconditionally consent to the service of any and all process in any such action or proceeding by the mailing of copies of such process by certified mail to the Sellers and the Company and their counsel at their respective addresses specified in Section 11.2. Sellers and the Company further irrevocably and unconditionally agree that a final judgment in any such action or proceeding (after exhaustion of all appeals or expiration of the time for appeal) shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

11.8. Accounting Terms. Any accounting terms used in this Agreement shall, unless otherwise specifically provided, have the meanings customarily given them in accordance with GAAP, and all financial computations hereunder shall, unless otherwise specifically provided, be computed in accordance with GAAP consistently applied.

11.9. Knowledge. For purposes of this Agreement, any reference to “**the knowledge of**” a party hereto when modifying any representation and warranty shall mean that such party has no knowledge after due inquiry that such representation and warranty is not true and correct to the same extent as provided in the applicable representation and warranty. The representations and warranties contained in this Agreement shall not be affected by any investigation, verification or examination by any party hereto or by anyone on behalf of any such party, or any knowledge of facts determined or determinable pursuant to such investigation.

11.10. Other Rules of Construction. References in this Agreement to sections, schedules and exhibits are to sections of, and schedules and exhibits to, this Agreement, unless otherwise indicated. Words in the singular include the plural and in the plural include the singular. The word “**or**” is not exclusive. The word “**including**” shall mean including, without limitation. The section and other headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Each party hereto acknowledges that this Agreement has been negotiated at arms’ length by the parties and their respective counsel and that neither party shall be deemed the author or drafter of this Agreement for purposes of construction of the terms hereof or for any other purpose. All parties hereto have participated substantially in the negotiation and drafting of this Agreement and each party hereby disclaims any defense or assertion that any ambiguity herein should be construed against the drafter.

11.11. Announcements. No announcement of this Agreement or any transaction contemplated hereby shall be made by any party prior to the Auburn Closing without the written approval of the other party hereto (which approval shall not be unreasonable withheld), except as required by law (including applicable federal or foreign securities laws) or the regulations of any securities exchange.

11.12. Partial Invalidity. In the event that any provision of this Agreement shall be held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

[Signature page to follow]

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed as of the date first written above.

BUYERS:

SELLERS:

DELTA GALIL USA INC.

GCW HOLDINGS, INC.

By:_____

By:_____

DELTA GALIL INDUSTRIES, LTD

KELLWOOD COMPANY

By:_____

By:_____

DELTA GALIL HOLLAND, B.V.

GCI SPAINCO, S.L.

By:_____

By:_____

**ACQUISITION OF STOCK
OF
AUBURN HOSIERY MILLS, INC.**

SCHEDULES

- 1.2 Life Insurance Policies
- 1.3 Shutdown Expenses
- 1.6 Allocation of Purchase Price
- 3.3 Agreements Requiring Consent
- 3.5 Due Organization
- 3.6 Financial Statements
- 3.7 Interim Changes
- 3.8 Banking Relationships and Investments
- 3.9 Accounts Receivable
- 3.10 Inventory
- 3.11 Fixed Asset Register
- 3.12 Insurance
- 3.13 Title to Assets
- 3.14 (a) Real Estate
- 3.14 (d) Real Estate Leases
- 3.15 Personal Property Leases
- 3.16 Intellectual Property
- 3.17 Software and Information Systems
- 3.18 Customers and Suppliers
- 3.19 (a) Employment Contracts
- 3.19 (b) Employees

- 3.19 (c) Unions
- 3.19 (h) Employee Terminations
- 3.20 Licenses and Permits
- 3.21 Material Contracts
- 3.22 Tax Matters
- 3.23 Product Warranties
- 3.24 Product Liability
- 3.25 Legal Proceedings
- 3.26 Environmental Matters
- 3.29 Employee Benefits
- 3.30 List of Other Countries Employee Benefits
- 3.31(h) Related Party Transactions
- 5.3 Interim Conduct of Business
- 10.2 (d) Guarantees

EXHIBITS

- 2.2 Wilson Letter Agreement

תל אביב, 23 ביוני 2004

לכבוד רשם החברות <u>ירושלים</u>	לכבוד הבורסה לניירות ערך <u>תל-אביב</u>	לכבוד הרשות לניירות ערך <u>ירושלים</u>
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הנדון: פרטים לגבי החברה

א.ג.נ,

להלן הפרטים הנדרשים על פי תקנה 8 לתקנות ניירות ערך (פרטי מסמך רישום, מבנהו וצורתו),
התשס"א – 2000 (להלן: "התקנות"):

1. מען משרדו הרשום של התאגיד:

בית הטכסטיל, רח' קויפמן 2, תל אביב 68012

טלפון: 03-5193636

פקס: 03-5193705

2. פרטי ההתקשרות עם החברה בארצות הברית (המדינה שבה רשומים ניירות הערך
של החברה למסחר):

א. מען: אצל Delta Galil USA Inc.

500 Plaza Drive

Secaucus, New Jersey 07094, USA

ב. מספר טלפון: 001-201-902-0055

ג. מספר פקס: 001-201-902-0070

3. סימן ניירות הערך של התאגיד בבורסה לניירות ערך בתל אביב הוא "דלתא"
ובבורסת ה-NASDAQ הוא "DELT".

4. שמו של האדם בתאגיד על פי סעיף 8 (3) לתקנות, בישראל ובארה"ב:

שם: יוסי חג'ג', סמנכ"ל כספים

כתובת: בית הטכסטיל, רח' קויפמן 2, תל אביב 68012

טלפון: 03-5193636

פקס: 03-5193705

בכבוד רב,

מיקי לקסר, חשב
דלתא גליל תעשיות בע"מ
ח.צ. 520025602