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CARMEL CONTAINER SYSTEMS LTD
Form 20-F
June 28, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

[] REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE
SECURITIES EXCHANGE ACT OF 1934

OR

[] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 1-9274

CARMEL CONTAINER SYSTEMS, LTD.

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

2 CHALAMISH STREET, CAESAREA INDUSTRIAL PARK 38900, ISRAEL

(Address of principal executive offices)

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

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
-----	-----
NONE	NONE

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

ORDINARY SHARES, NIS 1.0 PAR VALUE PER SHARE

(Title of Class)

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

NONE

(Title of Class)

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

2,520,000 ORDINARY SHARES, NIS 1.0 PAR VALUE PER SHARE

(119,813 of these shares are held by a subsidiary of the issuer)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No N/A

INTRODUCTION

We design and manufacture paper-based packaging and related products. We manufacture a varied line of products, including corrugated shipping containers, moisture-resistant packaging, consumer packaging, triple-wall packaging and wooden pallets and boxes. We were incorporated in 1983 under the laws of the State of Israel. In 1986, we completed the initial public offering of our ordinary shares, which are traded on the American Stock Exchange under the symbol "KML."

Except for the historical information contained in this annual report, the statements contained in this annual report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our business, financial condition and results of operations. 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 "Item 3. Key Information - D. Risk Factors" and elsewhere in this annual report.

We urge you to consider that statements which use the terms "believe," "do not believe," "expect," "plan," "intend," "estimate," "anticipate" and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels, or NIS, and in accordance with accounting principles generally accepted in Israel, or Israeli GAAP. All references in this annual report to dollars or "\$" are to U.S. dollars. In accordance with Israeli GAAP, all financial information presented in this annual report in NIS is presented in adjusted NIS, together with a convenience translation of the adjusted amounts to dollars. The representative exchange rate between the NIS and the dollar, as published by the Bank of Israel for December 31, 2003, was NIS 4.379 per \$1.00.

As used in this annual report, the terms "we," "us," "our" and "our company" mean Carmel Container Systems, Ltd. and its subsidiaries, unless otherwise indicated.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA.

The selected consolidated statement of income data set forth below with respect to the years ended December 31, 1999, 2000, 2001, 2002 and 2003 and the consolidated balance sheet data as of December 31, 1999, 2000, 2001, 2002 and 2003 have been derived from our audited consolidated financial statements that have been prepared in accordance with Israeli GAAP, which differs in certain respects from accounting principles generally accepted in the United States, or U.S. GAAP. See Note 21 to the consolidated financial statements for the differences between U.S. GAAP and Israeli GAAP, as applicable to the Company. The selected consolidated financial data set forth below should be read in conjunction with "Item 5. Operating and Financial Review and Prospects" contained herein, the consolidated financial statements which have been audited by Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global, independent auditors, and the notes to those statements included elsewhere in this document.

Selected Consolidated Financial Data

Adjusted NIS (1)
(In thousands, except per share data)
Year Ended December 31,

	1999	2000	2001
INCOME STATEMENT DATA:			
Revenues from sales, net.....	418,965	405,050	350,031
Cost of sales.....	346,644	350,878	316,328
Gross profit.....	72,321	54,171	33,703
Selling, general and administrative expenses.....	40,437	45,483	37,531

(1) We maintain our accounting records in nominal NIS. All amounts are presented in adjusted NIS, which have a constant purchasing power. The purchasing power of adjusted NIS reflects the average price level in December 2003, according to the Israeli Consumer Price Index, or CPI, published on January 15, 2004. See note 2 (b) to consolidated financial statements.

1999 2000 2001

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Operating income (loss).....	31,884	8,689	(3,828)
Financial expenses, net.....	11,641	8,504	10,862
Other income (expenses), net.....	47	736	152
Income (loss) before taxes on income.....	20,290	921	(14,538)
Taxes on income (tax benefit).....	7,324	(631)	(5,567)
Minority interest in losses (earnings) of a subsidiary.....	(230)	(545)	232
Net income (loss) for the year.....	12,736	1,007	(8,739)
Basic earnings (loss) per share.....	5.08	0.40	(3.64)
Weighted average number of shares outstanding.....	2,509	2,491	2,400
 BALANCE SHEET DATA:			
Working capital.....	50,235	67,683	57,915
Total assets.....	389,580	361,224	316,427
Long-term debt, including current maturities.....	93,401	91,057	84,694
Shareholders' equity.....	133,766	130,813	122,069

The following table sets forth, for the periods and dates indicated, certain information with respect to the exchange rate between the NIS and the dollar, based on the exchange rate published by the Bank of Israel for the periods indicated:

NIS PER DOLLAR

CALENDAR YEAR	AVERAGE (1)	HIGH	LOW	DECEMBER 31,
1999	4.1340	4.2760	4.0340	4.1530
2000	4.0745	4.1980	3.9670	4.0410
2001	4.2050	4.4160	4.0410	4.4160
2002	4.7490	4.9940	4.4370	4.7370
2003	4.5483	4.9240	4.2830	4.3790

(1) Based on the average exchange rate between the NIS and the dollar each month during the period.

The following table sets forth, for the periods indicated, the high and low exchange rates for NIS to dollars. These exchange rates are high and low exchange rates, as quoted by the Bank of Israel, for each month during the applicable period:

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NIS PER DOLLAR

MONTH/YEAR -----	HIGH ----	LOW ---
December 2003	4.441	4.352
January 2004	4.483	4.371
February 2004	4.493	4.437
March 2004	4.535	4.483
April 2004	4.599	4.515
May 2004	4.634	4.555

B. CAPITALIZATION AND INDEBTEDNESS.

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Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS.

Not applicable.

D. RISK FACTORS.

OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION COULD BE SERIOUSLY HARMED DUE TO ANY OF THE FOLLOWING RISKS, AMONG OTHERS. IF WE DO NOT SUCCESSFULLY ADDRESS THE RISKS TO WHICH WE ARE SUBJECT, WE COULD EXPERIENCE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION, AND OUR SHARE PRICE MAY DECLINE. WE CANNOT ASSURE YOU THAT WE WILL SUCCESSFULLY ADDRESS ANY OF THESE RISKS.

WE INCURRED A NET LOSS IN THE YEAR ENDED DECEMBER 31, 2003. WE MAY NOT BE ABLE TO RETURN TO PROFITABILITY IN THE NEAR FUTURE.

We reported a net loss of NIS 1.8 million (\$0.4 million) for the year 2003. If our volume of sales and the prices at which we sell our products do not increase, or if our expenses increase at a greater pace than our revenues, we will not return to profitability. Even if we return to profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis.

OUR MARKETS ARE HIGHLY COMPETITIVE, AND WE MAY NOT BE ABLE TO COMPETE SUCCESSFULLY.

We compete directly with a number of manufacturers of paper-based packaging products. Increased competition, direct or indirect, has adversely affected, and could adversely affect, our revenues and profitability through pricing pressure, loss of market share and other factors. We cannot assure you that we will be able to compete successfully against existing or new competitors as the market for our products evolves. Moreover, our existing and prospective competitors may have established, or may in the future establish, relationships with our existing and potential customers, which could have a material adverse effect on our ability to compete. In addition, we cannot assure you that our customers will not seek to manufacture their products through alternative sources and thereby eliminate the need to purchase our products. See "Item 4. Information on Our Company - B. Business Overview - Competition."

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WE ARE SUBJECT TO FLUCTUATING COSTS OF RAW MATERIALS.

The principal raw materials used in the manufacture of our products, kraftliner paper and recycled paper, are purchased in highly competitive, price-sensitive markets. These raw materials have historically exhibited price and demand cycles. The supply and price of kraftliner paper in particular is dependent upon a variety of factors over which we have no control, including environmental and conservation regulations, natural disasters, such as forest fires and hurricanes, and weather.

WE MAY BE ADVERSELY AFFECTED IF THE RATE OF DEVALUATION OF THE NIS AGAINST THE DOLLAR EXCEEDS THE RATE OF INFLATION IN ISRAEL.

While sales and payments for our products are made in NIS, we incur a significant portion of our expenses in dollars. As a result, we are exposed to the risk that the rate of devaluation of the NIS in relation to the dollar will exceed the rate of inflation in Israel. In the years 2001 and 2002, and in the three month period ending March 31, 2004, the rate of devaluation of the NIS

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against the dollar exceeded the rate of inflation in Israel (contrary to the circumstances in the years 1999, 2000 and 2003). We cannot predict any future trends. See "Item 5. Operating and Financial Review and Prospects - B. Liquidity and Capital Resources - Impact of Inflation and Devaluation on Results of Operations, Liabilities and Assets."

WE ARE SUBJECT TO VARIOUS RISKS RELATING TO OPERATIONS IN ISRAEL.

We are incorporated under the laws of, and our main offices and manufacturing facilities are located in, the State of Israel. We are directly influenced by the political, economic and military conditions in Israel. 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 the continued state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a significant escalation in violence between Israel and the Palestinians. Israel has experienced terrorist incidents within its borders, including in the West Bank and Gaza Strip. As a result, as of June 2004, negotiations between Israel and representatives of the Palestinian Authority have been sporadic and have failed to result in peace. We could be adversely affected by hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a continuous downturn in the economic or financial condition of Israel. In addition, several countries continue to restrict business with Israel and with companies having operations in Israel. We could be negatively affected by adverse developments in the peace process, including the recent violence, or by restrictive laws or practices directed towards Israel or Israeli exporters.

All male adult citizens and permanent residents of Israel under the age of 45 are, unless exempt, obligated to perform up to 39 days of military reserve duty annually. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. Some of our

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officers and employees are currently obligated to perform annual reserve duty. No assessment can be made as to the full impact of such requirements on our workforce or business if conditions in Israel should change, and no prediction can be made as to the effect of any expansion or reduction of such military obligations on us. See "Item 5. Operating and Financial Review and Prospects - B. Liquidity and Capital Resources - Political Conditions."

ITEM 4. INFORMATION ON OUR COMPANY

A. HISTORY AND DEVELOPMENT OF OUR COMPANY.

In January 1983, Carmel-Plaro Ltd., a private holding company, was organized under the laws of the State of Israel following the merger of Carmel Container Ltd. and Plaro Industries Ltd. In September 1986, Carmel-Plaro Ltd. merged with its two wholly-owned subsidiaries to form Carmel Container Systems, Ltd. In October 1986, we completed the initial public offering of our ordinary shares, NIS 1.0 par value per share, which are traded on the American Stock Exchange under the symbol "KML."

Our registered office in Israel is located at 2 Chalamish Street, Caesarea Industrial Park 38900, Israel, and our telephone number is 972-4-623-9350.

B. BUSINESS OVERVIEW.

GENERAL

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We are a leading Israeli designer and manufacturer of paper-based packaging and related products. We manufacture a varied line of products, including corrugated shipping containers, moisture-resistant packaging, consumer packaging, triple-wall packaging and wooden pallets and boxes. Our subsidiaries are: C.D. Packaging Systems Ltd. ("C.D."), a leading manufacturer of corrugated board-based and other consumer packaging in Israel, and Tri-Wall Containers (Israel) Limited ("Tri-Wall"), a manufacturer of heavy duty and bulk packaging made of triple-wall corrugated board and of wooden pallets and boxes for agricultural exports and other uses. In December 1995, C.D., together with Kappa Packaging International BV ("KPI"), a Dutch company, formed Solid Packaging Board Ltd. ("Solid") which marketed products manufactured by C.D. using the expertise and materials supplied by KPI. In December 2003, the operations of Solid were transferred to C.D. and Solid became inactive. Prior to November 24, 2003, the financial statements of Solid were consolidated into C.D.'s financial statements in accordance with the proportionate consolidation method. As of December 31, 2003, the financial statements of Solid were fully consolidated with C.D.'s financial statements.

Most of our products are made from corrugated board that we produce. We manufacture additional products made from duplex carton and wood. See "- Sources of Raw Materials." In 2003, we sold approximately 76,788 metric tons of paper-based corrugated packaging, compared to approximately 73,800 metric tons in 2002. One metric ton equals approximately 2,205 pounds.

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Our products are marketed to a wide variety of customers in Israel for diverse uses. Our sales to Israeli exporters amounted to approximately 10.8% and 11.7% of total sales in 2003 and 2002, respectively. The decline in sales to Israeli exporters in 2003 resulted from the overall decline in citrus exports from Israel.

SHIPPING CONTAINERS

We manufacture and market a broad range of shipping containers utilizing corrugated board that we produce. We operate two plants in Israel: a plant in Caesarea and a plant in Carmiel. See "- D. Property, Plants and Equipment."

Corrugated board containers conserve shipping and storage space because they are delivered knocked-down, unitized and can be adapted to modern material handling systems. Sales of corrugated board containers in 2003 were NIS 276.7 million (\$63.2 million), compared to NIS 260.7 million in 2002. Revenues from sales of corrugated board and corrugated board containers in 2003 increased by 6% as compared to 2002 due to increased sales and higher selling prices.

AUTOMATIC PACKAGING SYSTEMS

Our modern manufacturing process utilizes fully automated, box-making machinery that allows the corrugated trays to be created within our customers' own production facilities or in our regional facilities. The machinery utilized in this manufacturing process is imported from various manufacturers for our own use as well as for the use of our customers.

PAPER-BASED CONSUMER PACKAGING

Through C.D., we manufacture and market folding cartons and Micro-Fine corrugated board packaging, formerly known as E Flute, for use as packaging by manufacturers of consumer products. Sales of consumer packaging products in 2003 amounted to NIS 33.7 million (\$7.7 million) (approximately 9.6% of our consolidated sales), compared to NIS 31.5 million (approximately 9.3% of

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our consolidated sales) in 2002.

OUR SUBSIDIARIES

C.D. PACKAGING SYSTEMS LTD.

C.D. is a leading Israeli manufacturer of the Micro-Fine brand of fine corrugated board, the primary type of corrugated board used in consumer packaging. C.D. has developed an extensive range of graphics and printing techniques. Many of its Micro-Fine products are made with pre-printed litho-laminated sheets. This has enabled C.D. to respond to increased demand for easy-to-handle, sophisticated, promotional packaging containers, which are used partially for the export of consumer goods.

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C.D. was established in 1986 pursuant to a joint venture agreement between us and American Israeli Paper Mills Ltd., ("AIPM"), which since August 1992 has been one of our principal shareholders (see "Item 7. Major Shareholders and Related Party Transactions"). We control 50.1% of C.D., and AIPM controls the remaining 49.9% of C.D.'s shares. C.D. was established for the purpose of consolidating our paper-based consumer packaging operations with those of AIPM. Other than the production of Micro-Fine boards, all of our paper-based consumer packaging activity is conducted by C.D., which operates a state-of-the-art facility in Migdal Haemek, Israel.

Pursuant to the joint venture agreement between us and AIPM, C.D. must purchase, and we must supply, all of C.D.'s requirements for Micro-Fine board at prices acceptable to both parties, subject to certain limitations. We continue to sell Micro-Fine board to various customers in addition to C.D., and C.D. purchases raw materials from other suppliers. In 2003, C.D. purchased approximately 903 metric tons of Micro-Fine board from us for an aggregate sum of NIS 3.1 million (\$0.7 million), compared to 830 metric tons of Micro-Fine board that they purchased from us in 2002 for an aggregate sum of NIS 3.3 million.

In December 1992, C.D. was granted approved enterprise status pursuant to the Israeli Law for the Encouragement of Capital Investments (1959), or the Investment Law, with respect to its expansion program at its manufacturing facility. The program related to the acquisition of equipment utilized in the manufacture of C.D.'s board packaging in an aggregate amount of approximately \$4.4 million, 38% of which was to be funded by a state grant. In 1997, C.D. completed its expansion program following the installation of new equipment costing approximately \$4.3 million, of which approximately \$1.7 million was funded by a state grant.

In December 1999, C.D. submitted the approved enterprise final report to the Investment Center of the Ministry of Industry and Commerce of Israel, or the Investment Center. In October 2001, the head of the audit department in the Investment Center informed C.D. that he may recommend that the Investment Center cancel the approval that was granted in 1992 because of C.D.'s non-compliance with the terms and conditions required by the approval. On December 8, 2002, the Investment Center retroactively cancelled the 1992 approval granting C.D. approved enterprise status. As a result C.D. is required to refund certain investment grants in the amount of \$400,000 which are to be paid in 36 equal monthly installments commencing August 2002. Further, C.D. has committed to continue to employ a fixed number of employees, as determined by the Investment Center, until July 2005.

In December 1995, C.D., together with KPI, formed Solid Packaging Board Ltd., a company that markets products manufactured by C.D. using the

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expertise and materials supplied by KPI. KPI's sales in 2003 totaled approximately NIS 1.04 million (\$240,000), compared to sales of NIS 1.3 million in 2003. In December 2003, the operations of Solid were transferred to C.D. and Solid became inactive. Prior to November 24, 2003, the financial statements of Solid were consolidated into C.D.'s financial statements in accordance with the proportionate consolidation method. As of December 31, 2003, the financial statements of Solid were fully consolidated with C.D.'s financial statements.

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TRIPLE-WALL PACKAGING AND WOODEN PALLETS AND BOXES

Tri-Wall, our wholly-owned subsidiary, is a leading Israeli manufacturer of heavy duty and bulk packaging made of triple-wall corrugated board and of wooden pallets and boxes for agricultural exports and other uses. Tri-Wall manufactures triple-wall packaging in its Netanya, Israel plant. The wooden pallets and boxes are manufactured in Tri-Wall's plant in Netivot, Israel. Tri-Wall's sales in 2003 were NIS 52.8 million (\$12.0 million) (approximately 15.1% of our consolidated sales), compared to NIS 59.7 million (approximately 17.7% of our consolidated sales) in 2002. We manufacture the triple-wall board utilized by Tri-Wall and sell the board to Tri-Wall at current market rates. In 2003, Tri-Wall purchased 1,710 tons of triple-wall board from us at an aggregate sum of NIS 6.0 million (\$1.4 million), compared to the 1,720 tons of triple-wall board purchased by Tri-Wall at an aggregate sum of NIS 6.8 million in 2002.

In May 1991, pursuant to the Investment Law, Tri-Wall was granted approved enterprise status with respect to an expansion program at its manufacturing facility in Netivot, Israel. The cost of the program was an aggregate amount of approximately \$550,000. In 1995, Tri-Wall invested approximately \$461,000 and received approximately \$175,000 of state grants with respect to such approved enterprise. In February 1997, Tri-Wall received approval for an investment of \$576,000 to be used for further expansion, of which 34% (\$195,840) is to be funded by the Government of Israel in the form of grants. As of December 31, 2000, Tri-Wall invested approximately NIS 2.1 million (\$474,000) with respect to such approved enterprise, of which NIS 663,000 (\$150,000) was funded by a state grant. Tri-Wall did not invest with respect to such approved enterprise in the years ended December 31, 2001, 2002 and 2003.

We provide certain management services and license certain technology relating to the manufacture of triple-wall corrugated board to Tri-Wall. In 2003, Tri-Wall paid us management fees and royalties amounting to approximately NIS 2.1 million (\$480,000), compared to NIS 2.3 million in 2002.

SALES AND MARKETING

We sell our shipping containers directly to customers in Israel principally through the efforts of our management, in-house sales force and agents. C.D. and Tri-wall market their products directly to customers as well.

Our products are sold to over 500 customers in Israel. In 2003, approximately 70 of our customers accounted for approximately 80% of our net sales, in the aggregate. In 2003, we sold approximately 76,768 metric tons of paper-based corrugated packaging, compared to approximately 73,800 metric tons in 2002, an increase of 4.0% as compared to 2002.

Packaging for exported agricultural products constitutes a significant portion of our sales. Total sales of containers for export decreased by approximately 4% in 2003, as compared to 2002. This decrease was primarily caused by a 8% decrease in sales of containers used for the export of citrus fruit, as compared to 2002. Sales to Tri-Wall of containers used for the export

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of hi-tech products and the sale of containers for non-citrus agricultural exports remained the same as in 2002. Sales of containers to be used for domestic agricultural products increased by approximately 2% compared to 2002. In 2003, sales of containers for use in the food industry increased by 6% compared to 2002. Sales of containers for the beverage industry increased by 7% in 2003, compared to 2002. Sales of containers for other industries increased by 10% in 2003, compared to 2002. Sales of boards for miscellaneous use increased by 2%, compared to 2002. In 2003, the average price of our products increased by 2%, compared to 2002. This increase was the result of improvements in quality, delivery times, product mix and customer service.

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SEASONALITY

Some of our containers are used to transport agricultural products, including citrus fruits. As a result, sales of some of our products are influenced by the agricultural harvest in Israel, which occurs in autumn and winter.

SOURCES OF RAW MATERIALS

Our principal raw material is paper, mainly kraft linerboard, semi-chemical paper and recycled paper. In 2003, we purchased approximately 48% of our paper supplies, in terms of value, from domestic suppliers in Israel and imported 52% of our paper supplies. Of our imported paper supply, 15% is imported from the United States and 37% is imported from Europe and other countries. In 2003, we purchased all of our domestic paper supply from AIPM, and 22% of our imported paper supply, in terms of value, from International Forest Products Corporation (see "Item 7. Major Shareholders and Related Party Transactions"). We obtain our supply of recycled paper from Israeli sources and all other types of paper from import sources.

Prices of imported paper were stable through 1998 and until the end of the third quarter of 1999. Prices increased slightly in the fourth quarter of 1999 and continued to increase until the third quarter of 2000. Prices began to decrease in the fourth quarter of 2000 and continued to decrease through 2001 and the first quarter of 2002. Prices stabilized in the second quarter of 2002 and remained stable through the third quarter of 2002. In the fourth quarter of 2002, prices began to increase and continued to increase through the first quarter of 2003. Prices began to decrease in the second quarter of 2003 and remained stable throughout 2003. Prices decreased in the first quarter of 2004.

Prices of recycled domestic paper were stable in 1999 and through the third quarter of 2000, but slightly decreased in the fourth quarter of 2000, throughout the year 2001 and in the first quarter of 2002. Prices stabilized in the second quarter of 2002 through the fourth quarter of 2002. Prices began to decrease slightly in the first quarter of 2003 and remained stable throughout 2003. Prices increased substantially in the first and second quarter of 2004.

The raw materials that we require for the manufacture of our other products are readily available both from Israeli producers and from import sources.

COMPETITION

In addition to our company, there are three manufacturers of corrugated board and corrugated board shipping containers in Israel. Our strongest competitor in the manufacture and marketing of corrugated board and corrugated board shipping containers is Cargal Ltd. ("Cargal").

We estimate that in 2003, we and Cargal accounted for approximately 30% and 26%, respectively, of the total Israeli market for corrugated board and corrugated board shipping containers. We, Cargal and a third company, I.M.A. Itzur Mutzareit Ariza, collectively, manufacture approximately 77% of the corrugated board packaging in Israel. Our competitive strategy is based principally on customer service and the diversity of our products. The fourth manufacturer of corrugated board and containers in Israel is Best Carton Ltd., which entered the market in 1998. The entry of Best Carton Ltd., which manufactures approximately 18% of the corrugated board packaging in Israel, has contributed to the erosion of prices in the market, particularly in the market for packaging agricultural goods. See "Item 10. Additional Information - C. Material Contracts." During the year 2003 we experienced competition from Turkish importers of packaging products for agricultural goods. Imported packaging products from Turkey are significantly cheaper than domestic products and accounted for approximately 3% of the total Israeli market. The entry of imported packaging products from Turkey in 2001 significantly contributed to the decrease of prices in the market.

We, through C.D., are the leading manufacturer of corrugated board-based consumer packaging in Israel. There are four major manufacturers of corrugated board-based consumer packaging in Israel, including C.D., as well as a number of smaller manufacturers. Of the four major Israeli producers of corrugated board packaging, we are the only producer of consumer packaging. We compete in the consumer packaging field with three other companies, as well as with direct and indirect imports amounting to approximately 17% of the market.

Tri-Wall supplies over 65% of the Israeli market for triple-wall board packaging. Cargal's introduction of a triple-wall board packaging product to the market in 2001 has resulted in increased competition and has contributed to the decrease of Tri-Wall's market share for these products. Tri-Wall is one of the leaders in the field of wood shipping pallets. However, Tri-Wall has several competitors in that field, including a subsidiary of Cargal.

ENVIRONMENTAL REGULATION MATTERS

Certain of our manufacturing operations are subject to Israeli environmental and pollution control laws. In order to comply with these laws, we have installed scrap paper recovery systems and we sell balled scrap for recycling. We have also installed a system to prevent pollution from liquid wastes at our plant in Caesarea. In addition, we use printing inks made of organic materials rather than of metallic printing inks.

C. ORGANIZATIONAL STRUCTURE.

The following is a list of our subsidiaries and our percentage ownership:

Name of Company -----	Percentage of Ownership -----
(Operating Subsidiaries)	
Tri-Wall Containers (Israel) Ltd.	100
C.D. Packaging Systems Ltd.	50 (2)
Solid Packaging Board Ltd. (3)	50

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(Inactive Subsidiaries)

Plaro Container Systems (1989) Ltd.	100
Tri-Wall Pallets (1973) Ltd.	100

D. PROPERTY, PLANTS AND EQUIPMENT.

Our Caesarea plant began partial-capacity operations at the end of 1996 and became fully operational in 1997. The plant consists of approximately 377,000 square feet and is leased through our wholly-owned subsidiary, Plaro Container Systems (1989) Ltd. ("Plaro"). Plaro entered into a 20-year lease agreement that commenced in June 1996 with Gev-Yam High-Tech Ltd. ("Gev Yam"), for the lease of approximately 935,000 square feet of land (the "Site"), on which Gev Yam built the plant. We installed newly-purchased equipment and relocated equipment from our Tirat HaCarmel and Holon facilities. In 2003, we paid NIS 9.2 million (\$2.1 million) in rent with respect to the Site.

Plaro provided guarantees to Gev Yam in the aggregate of \$4.0 million from AIPM, Ampal Enterprises Ltd. ("AMPAL") and Rand-Whitney Group LLC (a wholly-owned subsidiary of Kraft Group LLC), our principal shareholders. See "Item 7. Major Shareholders and Related Party Transactions." In addition, Plaro entered into a management agreement with Caesarea Edmond Benjamin de Rothschild Development Company Ltd., the original owner and lessor of the Site, pursuant to which Plaro is required to pay various municipal charges. Pursuant to an option agreement between Plaro and Gev Yam, dated May 25, 1994, Plaro was granted an option to buy the Site commencing as of the 13th year of the lease, at a price to be determined by an independent appraiser in accordance with a mechanism set forth in such option agreement.

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- (2) As a result of our joint venture agreement with AIPM, we control 50.1% of C.D. Packaging Systems Ltd.
 - (3) C.D. Packaging Systems Ltd. holds 50% of Solid Packaging Board Ltd.'s equity interests. Solid ceased its activities by November 24, 2003.

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We lease a building in Carmiel, with an area of approximately 85,700 square feet, pursuant to a lease that commenced in June 1994. Since 1994, we expanded the plant at a cost of approximately \$730,000, which was paid by the landlord. Following the above-mentioned expansion of the plant, the lease agreement was extended until May 31, 2007. The annual rent for our Carmiel facility in 2003 was NIS 937,000 (\$214,000). This facility principally produces Micro-Fine boards for consumer packaging as well as other corrugated board products. In June 1998, we began to lease 13,000 square feet of storage in a nearby building, and in May 2000, we began to lease an additional 7,300 square feet of storage in this same building. Recently, we amended the two lease agreements in order to synchronize the agreement terms and options. The term for both agreements terminated on June 30, 2003, and we renewed for two additional years. We intend to renew both agreements for a term of at least one year. The annual rent for the two additional leases, which is linked to the Israeli consumer price index, or CPI, amounted in 2003 to NIS 268,000 (\$61,000).

C.D. leases approximately 81,000 square feet of industrial building space in Migdal Haemek near Haifa. The lease expired in January 2004, and we extended it on the same terms until December 2006. In 2003, the annual rent payment for C.D.'s Migdal Haemek facility, which is linked to the dollar and the CPI, was approximately NIS 1.3 million (\$297,000).

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Tri-Wall owns land (with an area of approximately 53,000 square feet) and an industrial building (with an area of approximately 30,000 square feet) located in Netanya's industrial area. Tri-Wall entered into an agreement with an unaffiliated third party to lease a portion of the Netanya facility for a term of three years beginning June 1, 1999 at an annual rent of \$78,000. This lease was amended in 2000 to include the entire Netanya Facility. In 2002, the total income generated from this lease amounted to NIS 474,000 (\$108,000). Tri-Wall has extended the term of this lease until 2004.

Tri-Wall also owns land and an industrial building in Netivot, where Tri-Wall's wooden pallet and box manufacturing facility is located. The area of the plot is approximately 160,000 square feet.

Tri-Wall's container manufacturing plant consists of approximately 56,000 square feet on a plot of approximately 135,000 square feet. This plant is located in a facility in Netanya which Tri-Wall sub-leased from Rav Kol-Bo Tagar (Wechselman) Ltd. The term of the sub-lease expired in November 1997. Tri-Wall has not entered into any formal agreement to extend the sub-lease, but continues to make monthly payments in accordance with the terms set forth in the expired sub-lease agreement. The annual rent reserved by Tri-Wall for this plant in 2003 was approximately NIS 1.0 million (\$230,000).

In 2003, Tri-Wall was notified by the municipality of Netanya of the municipality's intention to expropriate, without consideration, approximately 24,000 square feet of the property on which Tri-Wall's factory is situated in order to construct a public road. See "Item 8. Financial Information - A. Consolidated Statements and Other Financial Information - Legal Proceedings."

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS.

CERTAIN CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in Israel which differ in certain respects from generally accepted accounting principles in the United States (See Note 21 to the consolidated financial statements). For additional information regarding our significant accounting principles see Note 2 to our consolidated financial statements included as a part of this annual report on Form 20-F. While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. These policies are those that are both most important to the portrayal of our financial condition and results of operations and require our management's most difficult, subjective and complex judgments and estimates. Actual results could differ from those estimates.

We maintain our accounts and present our financial statements in NIS adjusted for changes in the general purchasing power of the Israeli currency. In accordance with Israeli GAAP, all financial information presented in this annual report in NIS is presented in adjusted NIS. This presentation permits the financial information to be set forth in constant terms as measured by changes in the CPI with a convenience translation of the adjusted amounts to dollars. See note 2(b) to consolidated financial statements. These accounting principles require management to make certain estimates, judgments and assumptions based upon information available at the time that they are made, historical experience and various other factors that are believed to be reasonable under the

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circumstances. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented.

In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles in Israel and in the United States and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. Our management has reviewed these critical accounting policies and related disclosures with the Audit Committee.

Our management believes the significant accounting policies which affect management's more significant judgments and estimates used in the preparation of our consolidated financial statements and which are the most critical to aid in fully understanding and evaluating our reported financial results include revenue recognition, allowance for doubtful accounts, inventory valuation, impairment of long-lived assets and deferred income taxes.

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REVENUE RECOGNITION

We derive our revenue primarily from one source: product revenues. Revenue related to sales of our products is generally recognized when persuasive evidence of an agreement exists; the product has been delivered and title and risk of loss have passed to the buyer; the sales price is fixed and determinable; no further obligations exist and collectibility is probable.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which is included in bad debt expense. We determine the adequacy of this allowance by regularly reviewing the complexion of our accounts receivable aging and evaluating individual customer receivables, considering customers' financial condition, credit history and current economic conditions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required in future periods.

INVENTORY

The Company's inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method for raw materials and materials in transit. Cost for supply and materials inventories is determined on the basis of moving-average cost. Cost for work in progress and finished products is determined on the basis of computed direct manufacturing costs with allocable indirect manufacturing costs.

INVENTORY VALUATION

At each balance sheet date, we evaluate our inventory balance for obsolescence. This evaluation includes analyses of sales levels by product line and projections of future demand. In addition, we write off inventories that are considered obsolete. Remaining inventory balances are adjusted to the lower of cost or market value. If future demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of sales in the period the revision is made.

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IMPAIRMENT OF LONG-LIVED ASSETS

Our long-lived assets include property, plant and equipment. In assessing potential impairment of these assets, we consider this factor and other pertinent information. We record an asset impairment charge when we believe that the asset has experienced a decline in value that is other than temporary.

In assessing the recoverability of our property and equipment and other intangible assets, we must make assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations for a Disposal of a Segment of a Business." FAS 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged.

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DEFERRED INCOME TAXES

We record income taxes using the asset and liability approach. Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and net operating loss and tax credit carryforwards. Significant management judgment is required in determining our provision for income taxes. We have considered future taxable income, prudent and feasible tax planning strategies and other available evidence in determining the need for a valuation allowance. We evaluate all of these factors to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

EFFECTS OF NEW ACCOUNTING STANDARDS ON OUR FINANCIAL STATEMENTS

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements, and Accounting Standard No. 13 with respect to the effect of changes in foreign exchange rates. In December 2002, Accounting Standard No. 17 was published with respect to the deferral of the effective date of Accounting Standards No. 12 and No. 13 to January 1, 2004. According to Accounting Standards No. 12 and No. 17, which deal with the discontinuance of the adjustment of financial statements, financial statements will cease to be adjusted for inflation in Israel beginning January 1, 2004. Until December 31, 2003, the Company continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements as of December 31, 2003 will serve as the starting point for nominal financial reporting beginning January 1, 2004.

YEAR ENDED DECEMBER 31, 2003 COMPARED TO YEAR ENDED DECEMBER 31, 2002

SALES

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Our consolidated sales in 2003 were NIS 349.9 million, (\$79.9 million), as compared to NIS 337.6 million for 2002. The increase in sales in 2003, as compared to 2002, reflected a quantitative increase in the amount of goods sold, with a slight increase in selling prices.

COST OF SALES

Cost of sales in 2003 amounted to NIS 314.3 million (\$71.8 million), compared to NIS 311.2 million in 2002. The cost of sales percentage was 89.8% of sales in 2003, compared to 92.1% of sales in 2002. This decrease in the cost of sales percentage resulted primarily from a reduction in our cost of materials and a decrease in depreciation expenses due to certain assets which have been fully depreciated.

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GROSS PROFIT

Gross profit for 2003 was NIS 35.7 million, (\$8.1 million), representing 10.2% of sales, as compared to NIS 26.4 million, representing 7.9% of sales, for 2002. The increase in gross profit resulted from the slight decrease in prices of raw materials during 2002 and a slight improvement in selling prices, combined with a quantitative growth in the sales volume.

SELLING EXPENSES

Selling expenses in 2003 totaled NIS 17.3 million (\$4.0 million), compared to NIS 16.8 million in 2002. This increase in selling expenses resulted primarily from an increase in salary and transportation expenses.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses in 2003 were NIS 17.8 million (\$4.1 million), or 5.1% of sales, compared to NIS 17.7 million in 2002, representing 5.2% of sales in 2002.

OPERATING INCOME (LOSS)

Operating income before financial expenses was NIS 0.6 million (\$0.1 million) for 2003, as compared to operating loss before financial expenses of NIS 8.1 million for 2002.

FINANCIAL EXPENSES

Financial expenses for 2003 were NIS 5.2 million (\$1.1 million), representing 1.5% of sales, as compared to NIS 6.1 million, representing 1.8% of sales, for 2002.

The decrease in actual financial expenses in 2003, as compared to 2002, resulted from the decrease in financial liabilities to banks during 2003, as compared to 2002, and the decrease in actual interest as the result of the ratio between the rate of inflation and the rate of devaluation of the NIS against the U.S. dollar, as compared to this ratio in 2002.

OTHER INCOME (EXPENSES)

Other income for 2003 was NIS 0.1 million as compared to net expenses of NIS 1.2 million in 2002. These expenses in 2003 include NIS 1.3 million (\$0.3 million) that the Company incurred in the last nine months of the year for a project designed to increase the efficiency of the Company's operating and

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production systems and to reduce the costs of such operating systems.

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INCOME BEFORE TAXES ON INCOME (LOSSES)

Loss before taxes for 2003 was NIS 4.5 million (\$1.0 million), representing 1.3% of sales, as compared to loss before taxes of NIS 15.3 million for 2002, representing 4.5% of sales during that period.

TAXES

Tax benefit on income for 2003 was NIS 2.6 million (\$0.6 million), as compared with a tax benefit on income of NIS 5.9 million for 2002.

MINORITY INTEREST IN NET INCOME (LOSS) OF C.D. PACKAGING SYSTEMS LTD.

The minority interest in the net loss of C.D. amounted to NIS 0.0 million (\$0.0) in 2003, compared to interest in net loss of NIS 0.8 million in 2002.

NET INCOME (LOSS)

Net loss for 2003 was NIS 1.8 million (\$0.4 million), representing 5.2% of sales, as compared to a loss of NIS 8.6 million in 2002.

WEIGHTED INCOME (LOSS) PER SHARE

Weighted loss per share for 2003 was NIS 0.77 (\$0.18), as compared to net loss per share of NIS 3.56 (\$0.81) for 2002.

YEAR ENDED DECEMBER 31, 2002 COMPARED TO YEAR ENDED DECEMBER 31, 2001

SALES

Our consolidated sales in 2002 amounted to NIS 337.6 million, compared to NIS 350.0 million in 2001, a decrease of 3.7%. The decrease in sales in 2002, as compared to 2001, reflected a quantitative increase with significantly eroded selling prices, resulting from the continuing recession and competition in the market.

COST OF SALES

Cost of sales in 2002 amounted to NIS 311.2 million, compared to NIS 316.3 million in 2001, a decrease of 1.6%. The cost of sales as a percentage of sales in 2002 was 92.1% of sales, compared to 90.4% of sales in 2001.

GROSS PROFIT

Gross profit in 2002 totaled NIS 26.4 million, compared to NIS 33.7 million in 2001, a decrease of 21.7%. The gross profit margins for 2002 were 7.9% of sales, compared to 9.6% of sales in 2001. The decrease in gross profit resulted from the significant erosion of sales prices with a quantitative increase and slight decrease in prices of raw materials during 2002.

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SELLING EXPENSES

Selling expenses totaled NIS 16.8 million in 2002, compared to NIS

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18.1 million in 2001. This decrease in selling expenses resulted primarily from a decrease in salary expenses.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses in 2002 decreased by 9.1% and were NIS 17.7 million, or 5.2% of sales, compared to NIS 19.5 million in 2001, representing 5.6% of sales in 2001. This decrease in general and administrative expenses resulted primarily from the decrease in management salaries, office expenses and a decrease in the reserve for unpaid debts.

OPERATING INCOME (LOSS)

Operating loss in 2002 amounted to NIS 8.1 million, compared to an operating loss of NIS 3.8 million in 2001.

FINANCIAL EXPENSES

Financial expenses in 2002 amounted to NIS 6.1 million, or 1.8% of sales, compared to NIS 10.9 million in 2001, or 3.1% of sales. This decrease in financial expenses of 44.0% was due primarily to a decrease in financial liabilities to banks during 2002, and the decrease in actual interest as the result of the ratio between the rate of inflation and the rate of devaluation of the NIS against the U.S. dollar. The rate of inflation was 6.5% in 2002, compared to 1.4% in 2001. The devaluation of the NIS compared to the dollar was 7.3% in 2002, compared to 9.3% in 2001.

OTHER INCOME (EXPENSES)

In 2002 we recorded other net expenses of NIS 1.2 million, compared to other income of NIS 0.2 million in 2001. These expenses in 2002 include NIS 1.3 million for a project designed to increase the efficiency in the Company's operating and production systems and to reduce the costs of such operating systems.

INCOME BEFORE TAXES ON INCOME (BENEFIT)

Loss before taxes in 2002 amounted to NIS 15.3 million, or 4.5% of sales, compared to a loss of NIS 14.5 million in 2001, or 4.2% of sales.

TAXES

Benefit from taxes in 2002 was NIS 5.9 million, compared to NIS 5.6 million in 2001.

MINORITY INTEREST IN NET INCOME (LOSS) OF C.D. PACKAGING SYSTEMS LTD.

The minority interest in the net loss of C.D. amounted to NIS 0.8 million in 2002, compared to interest in the net income of NIS 0.2 million in 2001.

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NET INCOME (LOSS)

Our net loss for 2002 was NIS 8.6 million, or 2.5% of sales, compared to a net loss of NIS 8.7 million in 2001, or 2.5% of sales.

WEIGHTED INCOME (LOSS) PER SHARE

Weighted loss per share in 2002 was NIS 3.56, compared to a weighted

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income per share of NIS 3.64 in 2001.

B. LIQUIDITY AND CAPITAL RESOURCES.

We meet our financial requirements primarily through funds provided by operations, long-term financing (long-term bank loans and other long term loans) and short-term financing (including short-term bank loans and credit provided by suppliers of materials).

During 2003, we experienced a positive cash flow of NIS 3.2 million (\$0.7 million), compared with a positive cash flow of NIS 17.7 million in 2002. This positive cash flow included depreciation of NIS 23.8 million (\$5.4 million), compared to a depreciation of NIS 25.6 million in 2002. Furthermore, we decreased our reserve for postponed taxes by NIS 2.6 million (\$0.6 million), compared to a decrease of NIS 6.3 million in 2002.

In 2003, we purchased equipment and invested in the infrastructure of our plants in an aggregate net amount of NIS 4.0 million (\$0.9 million), compared with similar investments in an aggregate net amount of NIS 1.9 million in 2002. We increased our long- and short-term loans by NIS 0.9 million (\$0.2 million), compared with payment of loans of NIS 15.7 million in 2002.

For the year ended December 31, 2003, we had positive working capital of NIS 53.1 million (\$12.1 million), compared with working capital of NIS 41.8 million for the year ended December 31, 2002. This increase in working capital resulted primarily from an increase in trade receivables, a decrease in inventories and an increase of short-term credit.

Long-term loans from banks and other financial sources amounted to NIS 32.6 million (\$7.4 million) (net of current maturities that included short-term loans) in 2003, compared to NIS 37.0 million in 2002.

Our only major investments, other than regular investments undertaken in the ordinary course of our business, in the four years ended December 31, 1999 are in our corrugated board manufacturing facilities, primarily in Caesarea. See "Item 4. Information on Our Company." During 1996, 1997, 1998 and 1999 our investments amounted to an aggregate of approximately NIS 170.2 million, of which we invested NIS 157.8 million in our corrugated board plants, primarily in the Caesarea plant.

During 2001 and 2000, we invested in our plant and infrastructure an aggregate amount of NIS 10.1 million and NIS 10.1 million, respectively, as part of our normal course of business. In 2002 and 2003, we invested NIS 1.9 million (\$0.4 million) and NIS 4.0 million (\$0.9 million), respectively, most of which was invested in our Caesarea plant to improve the production of corrugated cardboard.

IMPACT OF INFLATION AND DEVALUATION ON RESULTS OF OPERATIONS, LIABILITIES AND ASSETS

The dollar cost of our operations is influenced by the extent to which any inflation in Israel is or is not offset, or is offset on a lagging basis, by the devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, we experience an increases in the dollar cost of our operations in Israel. However, inflation in Israel, which is not offset by a devaluation of the NIS, will have a positive effect on our profitability, as we receive payment in NIS for most of our sales, while we incur a significant portion of our expenses in dollars.

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The following table presents information about the rate of inflation in Israel, the rate of devaluation of the NIS against the dollar and the rate of inflation in Israel adjusted for the devaluation:

YEAR ENDED DECEMBER 31, -----	ISRAELI INFLATION RATE % -----	NIS DEVALUATION RATE % -----	ISRAELI INFLATION ADJUSTED FOR DEVALUATION % -----
1999	1.3	(0.1)	1.4
2000	0	(2.7)	2.8
2001	1.4	9.3	(7.2)
2002	6.5	7.3	(0.7)
2003	(1.9)	(7.6)	(8.8)

A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities that are payable in NIS, unless those expenses or payables are linked to the dollar. This devaluation also has the effect of decreasing the dollar value of any asset that consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses.

We are exposed to a variety of market risks, including changes in interest rates and foreign currency fluctuations. Because exchange rates between the NIS and the dollar fluctuate continuously, with a historically declining trend in the value of the NIS, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period-to-period comparisons of our results. There can be no assurance that we will not be materially adversely affected in the future if devaluation of the NIS against the dollar exceeds the inflation in Israel. See "Item 3. Key Information - A. Selected Financial Data."

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POLITICAL CONDITIONS

We are directly influenced by the political, economic and military conditions in Israel. 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 the continued state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Since October 2000, there has been a significant escalation in violence, primarily in the West Bank and Gaza Strip, and more recently Israel has experienced terrorist incidents within its borders. As a result, negotiations between Israel and representatives of the Palestinian Authority have been sporadic and have failed to result in peace. We could be adversely affected by hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a continuous downturn in the economic or financial condition of Israel. In addition, several countries continue to restrict business with Israel and with companies having operations in Israel. We could be negatively affected by adverse developments in the peace process, including the recent violence, or by restrictive laws or practices directed towards Israel or Israeli exporters, such as our customers.

All male adult citizens and permanent residents of Israel under the age of 45 are, unless exempt, obligated to perform up to 39 days of military reserve duty annually. Additionally, these residents are subject to being called to active duty at any time under emergency circumstances. Many of our officers and employees are currently obligated to perform annual reserve duty. While we

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have maintained operations effectively under these requirements since we began operations, we cannot assess the full impact of these requirements on our workforce or business if conditions should change, and we cannot predict the effect on us of any expansion or reduction of these obligations.

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 intervened in various sectors of the economy by utilizing fiscal and monetary policies, import duties, foreign currency restrictions and controls of wages, prices and foreign currency exchange rates.

In 1998, the Israeli currency control regulations were liberalized significantly, as a result of which Israeli residents may deal in foreign currency and non-residents of Israel may purchase and sell Israeli currency and assets. The Israeli government has periodically changed its policies in all these areas. There are currently no Israeli currency control restrictions on remittances of dividends on the ordinary shares or the proceeds from the sale of the shares; however, legislation remains in effect pursuant to which currency controls can be imposed by administrative action at any time. In addition, Israeli residents are required to file reports pertaining to certain types of actions or transactions.

The Israeli government's monetary policy contributed to relative price and exchange rate stability in recent years, despite fluctuating rates of economic growth and a high rate of unemployment. We cannot assure you that the Israeli government will be successful in its attempts to keep prices and exchange rates stable. Price and exchange rate instability may have a material adverse effect on us.

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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 signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. 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.

Israel and the EEC, known as the European Union, concluded a Free Trade Agreement in July 1975 that confers certain advantages on Israeli exports to most European countries and obligates Israel to lower its tariffs on imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a free-trade area. The free-trade area has eliminated all tariff and specified non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as EFTA, which includes Austria, Finland, Iceland, Liechtenstein, Norway, Sweden and Switzerland, established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes redefinition of rules of origin and other improvements, including providing for Israel to become a member of the research and technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including China, India, Russia, Turkey

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and other nations in Eastern Europe and Asia.

C. RESEARCH AND DEVELOPMENT.

In 2002, we undertook a joint research project with the Volcani Center Agricultural Research Organization. The research project focused on the development of an improved corrugated board container that would prolong the shelf-life of citrus, and certain other fruits and vegetables. The project was concluded unsuccessfully in December 2002 at a cost to us of NIS 220,000 (\$46,000). The Chief Scientist of the Ministry of Industry and Commerce has committed to reimburse us for up to fifty percent of our investment.

D. TREND INFORMATION.

We are not aware of any significant trends in our industry.

E. OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any material off-balance sheet arrangements. In addition we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

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F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

	Payments due by period (NIS IN THOUSANDS)			
CONTRACTUAL OBLIGATIONS	TOTAL	2004	2005 - 2007	2008 AND THE
Long-Term Rent Obligations (4)	124,015	12,805	32,487	78,7
Capital (Finance) Lease Obligations	7,584	3,619	3,965	-
Operating Lease Obligations	2,286	980	1,306	-
Accrued Severance Pay (5)	8,874	-	-	8,8
Long-Term Loans	47,973	19,332	26,096	2,5
Total	190,732	38,740	63,854	90,1
	=====	=====	=====	=====

G. SAFE HARBOR

Except for the historical information contained in Item 5. Operating and Financial Review and Prospects - E. Off-Balance Sheet Arrangements and - F. Tabular Disclosure of Contractual Obligations, the statements contained in such sections are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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 "Item 3. Key Information - D. Risk Factors" and elsewhere in this annual report.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

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A. DIRECTORS AND SENIOR MANAGEMENT.

Our directors and executive officers are as follows:

Name	Age	Position with Company
Robert K. Kraft	63	Director, Chairman of the Board
Yaakov Yerushalmi	62	Vice Chairman of the Board, Chairman of the Management and Finance Committee
Richard A. Karelitz	54	Director, Chairman of the Audit Committee
Myra H. Kraft	60	Director
Jonathan A. Kraft	39	Director

 (4) We operate from leased premises in Israel.

(5) The accrued severance pay is considered to be a contractual obligation of ours for more than 5 years, as we do not anticipate at present the dismissal of our employees.

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Name	Age	Position with Company
Yoram Firon	35	Director
Richard P. Morse	72	Director
Avshalom Patir (6)	56	Director
Israel Eldar	58	Director
Irit Eluz	37	Director
David Harman	59	External Director
Doron Kempler	54	General Manager
Zeev Birenboim (7)	53	(Former) External Director
Menachem Kallach		External Director
Daniel Attias (8)	65	(Former) Chief Financial Officer
Nestor Szwarcberg	45	Chief Financial Officer
Moshe Balter	60	Secretary
Shimon Yarel	53	Internal Auditor

ROBERT K. KRAFT has been Chairman of our board of directors since March 1989 and a director since October 1988. For more than the past thirty years, Mr. Kraft has been the Chairman of International Forest Products Corporation, or IFPC, a company engaged in marketing and trading paper and

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related products and a supplier of raw materials, including to us. Mr. Kraft is also the President of Rand-Whitney Group LLC, a company engaged in the cardboard and packaging field and our shareholder; Chairman of Chestnut Hill Management Corp., an investment management company; President and Chief Executive Officer of the New England Patriots, a football team in the National Football League; and President and Chief Executive Officer of NPS LLC, which owns and operates Gillette Stadium in Foxborough, Massachusetts. He is also a director of Kraft Soccer LLC and Kraft Holdings Trust. Mr. Kraft is the husband of Myra H. Kraft and the father of Jonathan A. Kraft.

- (6) Avshalom Patir resigned on February 10, 2004.
- (7) Mr. Zeev Birenboim resigned on September 14, 2003 and his successor, Mr. Menachem Kallach was appointed early October 2003.
- (8) Mr. Daniel Attias resigned on December 31, 2003 and was replaced by Nestor Szwarcberg.

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YAAKOV YERUSHALMI has been a director of our company since August 1992 and Executive Vice Chairman of our board of directors and Chairman of the Management and Finance Committee since September 1992. Mr. Yerushalmi has served as Chairman of the Board of Directors of AIPM since January 1999 and served as General Manager of AIPM from June 1990 to March 2003. Mr. Yerushalmi currently serves as Chairman of Amnir Recycling Industries Ltd., as well as chairman or director of several subsidiaries or affiliates of AIPM.

RICHARD A. KARELITZ has been a director of our company since October 1988. He has been employed in various capacities with International Forest Products Corporation since 1975 and presently is its Senior Vice President. Mr. Karelitz also is Treasurer of Chestnut Hill Management Corp., an investment management company, and General Counsel to the New England Patriots, a football team in the National Football League, to the New England Revolution, a soccer team in Major League Soccer, and to NPS LLC, which owns and operates Gillette Stadium in Foxborough, Massachusetts. Mr. Karelitz is a director of IFP Products (UK) Limited, International Forest Products (H.K.) Limited, IFP Corporate Services SDN, BDH and International Forest Products Limited.

MYRA H. KRAFT has been a director of our company since August 1992. Mrs. Kraft is a director of International Forest Products Corporation and is an indirect holder of membership interests of Kraft Group. Mrs. Kraft is Robert K. Kraft's wife and the mother of Jonathan A. Kraft.

JONATHAN A. KRAFT has been a director of our company since August 1992. Mr. Kraft is a director of International Forest Products Corporation, Rand-Whitney Group LLC, Kraft Holdings Trust, CMGI, Inc., and Citizens Bank of Massachusetts. Mr. Kraft is also Chief Executive Officer of Rand-Whitney Containerboard, Vice Chairman of the New England Patriots, Investor-Operator of the New England Revolution, and President of NPS LLC, which owns and operates Gillette Stadium in Foxborough, Massachusetts. Mr. Kraft is the son of Robert K. Kraft and Myra H. Kraft.

YORAM FIRON has been a director of our company since November 5, 2002. Mr. Firon serves as Secretary and Vice President - Investments and Corporate Affairs of Ampal American- Israel Corporation and its subsidiaries. Prior to this position, Mr. Firon served as the Vice President of Merhav M.M.F. Ltd. and was a partner in the law firm of Firon Karni Sarov & Firon.

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RICHARD P. MORSE has been a director of our company since October 1988. Mr. Morse is a private investor who was formerly a Vice President and director of Morse Shoe, Inc.

AVSHALOM PATIR has been a director of our company since April 2003. Mr. Patir has served as the General Manager of AIPM since April 2003. From 1998 to April 2003 Mr. Patir served as General Manager of Barak I.T.C. (1995) - The International Telecommunications Services Corp. Ltd. Mr. Patir holds a Masters degree in Electrical Engineering. Mr. Patir also serves as a director of several subsidiaries or affiliates of AIPM.

ISRAEL ELDAR has served as a director of our company since August 2000. Mr. Eldar has served as the comptroller of AIPM Ltd. since 1985. Mr. Eldar serves as a director of several subsidiaries or affiliates of AIPM.

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IRIT ELUZ has been a director of our company since November 5, 2002. Ms. Eluz serves as the Chief Financial Officer and Vice President-Finance and Treasurer of Ampal American-Israel Corporation and its subsidiaries. Prior to that position, Ms. Eluz served as an Associate Chief Financial Officer of Merhav. From 1993 to 1998, Ms. Eluz served with M.M.F. Ltd. and as Chief Financial Officer of Karnor Ltd. Ms. Eluz serves as a Director of Ampal Development Ltd.

ZEEV BIRENBOIM in 1999 acted as Chief Executive Officer of Ampa Ltd., in 1996 V.P. for Marketing, Delek - Israel Petrol Co. Ltd., in 1994 Chief Executive Officer and member of the board of directors of Klal Retail Chains of Klal Group, in 1993 Chief Executive Officer, Bezeq Bit, and in 1990 Products Manager in Hogla Ltd.

DAVID HARMAN has served as Chief Executive Officer of TeachLink Ltd. (remote learning services) since 1998. From 1991 to 1998, he served as Chief Executive Officer of Joint Authority for Jewish Education of the Jewish Agency and the Zionist Agency. From 1987 to 1991, he was a Lecturer on Education at Columbia University. From 1984 to 1991, he was an Education Adviser and Chief Scientist for the American Jewish Joint Distribution Committee.

DORON KEMPLER was appointed as our General Manager on May 6, 2001. Mr. Kempler has been the Chief Executive Officer of our packaging paper and machinery division since October 1999. From 1996 to 1998, he was the manager of the fine paper mills in AIPM. From 1993 to 1996, he served as Vice President for Operations in the recycling division of AMIR Ltd. Mr. Kempler served in the Israeli Air Force for 25 years, retiring with the rank of Colonel.

MENACHEM KALLACH has been a director of our company since October 2003. Mr. Kallach has served as chairman of the boards of Royal Plaza Hotel in Tiberias, Israel and Food Club Group since 1999. He has been a director of Mitzpe Kineret Ltd. and Kineret (1995) Ltd. since 1999. From 1994 to 1998 Mr. Kallach served as general manager of Mitzpe Kineret Ltd. and served as chairman or director of several companies in the real estate, retail and marketing fields in Israel.

DANIEL ATTIAS served as our Chief Financial Officer from June 1985 until December 2003. From 1984 to 1985, Mr. Attias was General Manager of Jerusalem Paper Products, Ltd. (which subsequently changed its name to Ofek Paper Products Ltd. and was acquired by us).

NESTOR SZWARCBERG has been our Chief Financial Officer since January 1, 2004. Prior to joining the Company, Mr. Szwarcberg served as Chief Financial Officer of Polygal Plastics Industries Ltd from 2000 to 2003, Chief Financial

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Officer and Comptroller of Mezerplas Ltd from 1996 to 2000 and Chief Financial Officer of Histadrut from 1990 to 1996.

MOSHE BALTER was appointed as our Secretary on February 25, 1992. Mr. Balter is an Israeli attorney who has been practicing law since 1971.

SHIMON YAREL was appointed as our Internal Auditor on March 2, 1993. Mr. Yarel is an Israeli Certified Public Accountant in the firm of Yarel & Co., Accountants.

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EXTERNAL DIRECTORS

On July 30, 2000, Zeev Birenboim and David Harman were appointed as external directors of our company, as required by Israeli law. Pursuant to Israeli law, the external directors are appointed for a three-year term. Menachem Kallach was appointed in October 2003 after Zeev Birenboim resigned.

RESIGNATION OF DIRECTORS AND OFFICERS

Mr. Yoram Shetrit resigned as a director in March 31, 2003. Mr. Zeev Birenboim resigned on September 14, 2003 and his successor, Mr. Menachem Kallach, was appointed early October 2003. Mr. Daniel Attias resigned as Chief Financial Officer on December 31, 2003 and was replaced by Nestor Szwarcberg.

SHAREHOLDERS' AGREEMENT

On May 14, 1992, Robert K. Kraft, on the one hand, and AIPM and AMPAL, on the other hand, entered into a shareholders' agreement, or the Shareholders Agreement, which provides, among other things, that our board of directors will be comprised of twelve directors, of whom five are to be recommended by Mr. Kraft, three by AIPM, two by AMPAL and the remaining two will be External Directors pursuant to the requirements of Israeli law.

In accordance with the Shareholders' Agreement, the board of directors has established a Management and Finance Committee and an Audit Committee.

The Management and Finance Committee is comprised of four members, one recommended by each of Kraft, AMPAL and AIPM, respectively, and the fourth member being one of the External Directors. The Audit Committee is comprised of five members: the two External Directors and one director recommended by each of Mr. Kraft, AMPAL and AIPM, respectively.

Pursuant to the Shareholders' Agreement, the board of directors deals with any matters it considers to be material and delegates the remaining matters to the Management and Finance Committee, including compensation of our senior management. The Audit Committee deals with all matters required by Israeli law to be reviewed or approved by the Audit Committee.

The following matters require the affirmative vote of at least 80% of our directors: (i) any sale or disposition of any fixed assets, subsidiaries or investments of our company having value in excess of \$500,000; (ii) the issuance of our ordinary shares (which shall require a majority vote of 85%); (iii) any capital expenditures in excess of \$500,000; (iv) the incurrence of indebtedness or the granting of a guarantee in an amount exceeding \$500,000 and the granting of any security in connection therewith; (v) making loans to or investments in any third party in excess of \$500,000; (vi) curtailing or closing down material portions of our business, expanding into material new lines of business, making material acquisitions or entering into other new ventures if substantially

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different from our existing business; (vii) any transaction between us and any interested party or our affiliates; (viii) any decision regarding dividends (which shall require a majority vote of 85%); or (ix) changing the nature of our business (which shall require a majority vote of 85%).

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Pursuant to the Shareholders' Agreement, Mr. Kraft, AIPM and AMPAL have agreed to cooperate with respect to certain issues (i.e., mergers, amendments to our Memorandum and Articles of Association, dissolution and liquidation of our company, changes to our capital structure and payment of dividends) which may be voted on at shareholders' meetings. Mr. Kraft, AIPM and AMPAL have also granted each other certain rights of first refusal with respect to our ordinary shares held by them.

B. COMPENSATION.

The aggregate compensation paid to or accrued for the account of all of our directors and executive officers as a group during the 2003 fiscal year was NIS 3.1 million (\$0.71 million), of which NIS 0.8 million (\$0.186 million) was paid to or accrued for the account of our general manager. This amount includes directors' fees, officers' compensation, amounts set aside or accrued to provide pension, retirement or similar benefits and amounts expended by our company for automobiles made available to our officers and expenses (including business travel, professional and business association dues and expenses) for which our directors were reimbursed.

C. BOARD PRACTICES.

APPOINTMENT OF DIRECTORS AND TERMS OF OFFICE

Our directors are appointed by our shareholders at our annual general meeting and hold office until the next annual general meeting. Our annual general meetings are held at least once every calendar year, but not more than 15 months after the last preceding annual general meeting. In the intervals between our annual general meetings, our board of directors may appoint new directors to fill vacancies. Our officers serve at the discretion of our board of directors, subject to the terms of any agreement between them and us and the provisions of the Israeli Companies Law, 5739-1999, or the Companies Law.

EXTERNAL DIRECTORS

Under the Companies Law, companies incorporated under the laws of Israel whose shares have been offered to the public in or outside of Israel are required to appoint two external directors. The Companies Law requires that the external directors be residents of Israel. However, the Minister of Justice of the State of Israel has promulgated regulations exempting certain qualifying foreign companies, such as us, from the applicability of certain provisions of the Companies Law. The Companies Regulations (Concessions for Public Companies Whose Shares are Registered in a Stock Exchange Outside Israel), 5760-2000, as amended, define "foreign company" as a public company whose shares have been offered solely to the public outside of Israel or are registered only on a stock exchange outside of Israel. Pursuant to these regulations, an external director of a foreign company need not be an Israeli resident.

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The Companies Law provides that a person may not be appointed as an external director if the person or the person's relative, partner, employer or any entity under the person's control has, as of the date of the person's

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appointment to serve as an external director, or had, during the two years preceding that date, any affiliation with the company, any entity controlling the company or any entity controlled by the company or by this controlling entity. The term affiliation includes: (i) an employment relationship; (ii) a business or professional relationship maintained on a regular basis; (iii) control; and (iv) service as an office holder. The Companies Law further provides that if, at the time the external directors are appointed, a company's board of directors is comprised solely of members of the same gender, then at least one of the external directors must be of a different gender than the other directors.

No person can serve as an external director if the person's position or other business creates, or may create, conflicts of interest with the person's responsibilities as an external director. Until the lapse of two years from termination of office, a company may not engage an external director to serve as an office holder and cannot employ or receive services from that person, either directly or indirectly, including through a corporation controlled by that person.

External directors are to be elected by a majority vote at a shareholders' meeting, provided that either: (i) the majority of shares voted at the meeting, including at least one-third of the shares of non-controlling shareholders voted at the meeting vote in favor of the election; or (ii) the total number of shares voted against the election of the external director does not exceed one percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for an additional three years. Each of the external directors is required to serve on the company's audit committee. Each other committee of a company's board of directors is required to include at least one external director.

AUDIT COMMITTEE

Under the Companies Law, the board of directors of any company that is required to nominate external directors must also appoint an audit committee comprised of at least three directors, including all of the external directors, but excluding: (i) the chairman of the board of directors; (ii) the general manager; (iii) the chief executive officer; or (iv) any controlling shareholder or its relative and any director employed by the company or who provides services to the company on a regular basis.

The role of the audit committee is to examine flaws in the business management of the company, in consultation with the internal auditor and the company's independent accountants, and suggest appropriate course of action. Our audit committee meets three or four times a year, during which Mr. Yarel, our internal auditor, presents his quarterly report.

The approval of the audit committee is required to effect specified actions and transactions with office holders and interested parties. An interested party is defined in the Companies Law as a 5% or greater shareholder, any person or entity who has the right to designate one director or more or the general manager of the company or any person who serves as a director or as a

general manager. An audit committee may not approve an action or a transaction with an interested party or with an office holder unless at the time of approval the two external directors are serving as members of the audit committee, at least one of whom was present at the meeting in which any approval was granted.

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The current members of our audit committee are Richard A. Karelitz, chairman, Israel Eldar, Irit Eluz, Menachem Kallach and David Harman.

INTERNAL AUDITOR

Under the Companies Law, the board of directors must appoint an internal auditor proposed by the audit committee. Mr. Shimon Yarel has been our internal auditor since 1993. The role of the internal auditor is to examine whether the company's actions comply with the law, integrity and orderly business procedure. Under the Companies Law, the internal auditor may not be an interested party, an office holder, or an affiliate, or a relative of an interested party, an office holder or affiliate, nor may the internal auditor be the company's independent accountant or its representative.

D. EMPLOYEES.

As of December 31, 2003, we had 546 employees, including approximately 75 employees in management, finance and marketing, and approximately 477 full-time employees and 69 temporary employees in manufacturing. All of our employees are employed in Israel.

The following is a breakdown of our employees by main category of activity for the last three years.

Area of Employment -----	Employees -----		
	2001 ----	2002 ----	2003 ----
Manufacturing			
Permanent Employees	467	441	402
Temporary Employees	56	50	69
Management, Finance and Marketing	82	87	75
	---	---	---
Total	605	578	546
	===	===	===

We consider our relations with all of our employees to be satisfactory. Most of our employees are covered by three collective bargaining agreements. Certain of our employees, in particular, executive officers and those employed in management, finance and marketing, as well as certain key employees in manufacturing, have entered into personal employment contracts with us. In addition, by order of the Israeli Ministry of Labor and Welfare, certain provisions of the collective bargaining agreement between the Histadrut (General Federation of Labor in Israel) and the Coordinating Bureau of Economic Organizations (a central organization representing most of Israel's employers'

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associations) are applicable to all of our employees. These provisions principally concern the length of the work day and the work week, insurance for work-related accidents, minimum daily wages, pension fund contributions, procedures for dismissing employees, determination of severance pay and other conditions of employment. The wages of most of our employees are linked, in part, to the CPI.

Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute (which is similar to the United States Social Security Administration). These payments amount to approximately 14.82% of total compensation, with the employee contributing approximately 4.50% and the employer contributing the balance. The majority of our permanent employees

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are covered by pension insurance policies and pension funds providing customary benefits to employees, including retirement and severance benefits. We contribute 13.3% (which includes 8-1/3% of severance pay) of base wages to such plans and the employee contributes between 5% to 5.5% of base wages. Under Israeli law, employees are required to contribute up to 4.8% of their total compensation to the National Insurance Institute for health insurance coverage.

E. SHARE OWNERSHIP.

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and executive officers as of June 20, 2003.

NAME ----	NUMBER OF ORDINARY SHARES BENEFICIALLY OWNED (9) -----	PERCENTAGE OF OUTSTANDING ORDINARY SHARES (10) -----
Robert K. Kraft	851,174	35.46% (11)
Richard A. Karelitz	11,550	Less than 1%
Richard P. Morse	1,250	Less than 1%

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- (9) Except as otherwise noted and pursuant to applicable community property laws, each person named in the table has sole voting and investment power with respect to all ordinary shares listed as owned by such person.
- (10) Ordinary shares deemed beneficially owned by virtue of the right of any person or group to acquire such shares within 60 days of June 30, 2003 are treated as outstanding only for the purposes of determining the percent owned by such person or group.
- (11) In calculating this percentage only outstanding shares with voting rights were considered. Tri-Wall's 119,813 non-voting shares were not considered.

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ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS.

The following table sets forth certain information as of May 31, 2004, pertaining to the beneficial ownership of our ordinary shares, by persons known to us to own 5% or more of our ordinary shares. Except as disclosed below, we are not directly or indirectly owned or controlled by another corporation or by any foreign government.

The information contained herein has been obtained from our records, or from information furnished directly by the individual or entity to us.

Name of Beneficial Owner (12) -----	Number of Shares Owned	Percent of Class (13) -----
Kraft Group LLC	275,000 (14)	11.46%
American-Israeli Paper Mills Ltd.	630,000 (15)	26.25%
Ampal Enterprises Ltd.	522,000 (15)	21.75%
Robert K. Kraft	851,174 (16)	35.46%
All Directors and executive officers as a group (16 Persons)	863,974 (17)	36.00%

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- (12) The address of each of Kraft Group LLC ("Kraft Group") and Robert K. Kraft is One Patriot Place, Foxborough, MA 02035. The address of American-Israeli Paper Mills Ltd. ("AIPM") is P.O. Box 142, Hadera, Israel. The address of Ampal Enterprises Ltd. ("AMPAL") is 111 Arlozorov St., Tel-Aviv, Israel.
- (13) In calculating this percentage only outstanding shares with voting rights were considered. Tri-Wall's 119,813 non-voting shares were not considered.
- (14) Excludes 470,324 ordinary shares beneficially owned by Robert K. Kraft, the President of the managing member and an indirect holder of membership interests of Kraft Group; 26,250 ordinary shares beneficially owned by Richard P. Morse (a Director of the Company), 25,000 of which Mr. Robert K. Kraft has the right to vote pursuant to an agreement between Messrs. Morse and Kraft; 52,500 ordinary shares owned by the Kraft Foundation (of which Mr. Robert K. Kraft is a Trustee with shared investment and voting authority); 2,100 ordinary shares beneficially owned by Myra H. Kraft (Mr. Kraft's wife), an indirect holder of membership interests of Kraft Group; and 26,250 ordinary shares beneficially owned by the Kraft Irrevocable Family Trust (6,562 shares of which are owned for the benefit of Jonathan A. Kraft (Mr. & Mrs. Kraft's son), an indirect holder of membership interests of Kraft Group). See footnote 16 below.
- (15) On July 31, 1992, Robert K. Kraft, AIPM and AMPAL entered into an agreement pursuant to which Robert K. Kraft (after having purchased from Carmel Plaro Holdings Limited, Koor Industries Ltd. and Koor Foods Ltd. all the Ordinary Shares beneficially owned by them) transferred 630,000 ordinary shares to AIPM and 514,000 Ordinary Shares to AMPAL. AMPAL has since increased its Ordinary Share holdings to 522,000.
- (16) Includes 26,250 Ordinary Shares beneficially owned by Mr. Richard P. Morse (a Director of the Company), 25,000 of which Mr. Robert K. Kraft has the right to vote pursuant to an agreement between Messrs. Morse and Kraft, and 52,500 Ordinary Shares owned by the Kraft Foundation (of which Mr. Robert K. Kraft is a Trustee with shared investment and voting authority). Also includes 2,100 Ordinary Shares beneficially owned by Mrs. Myra H. Kraft (Mr. Kraft's wife), 26,250 Ordinary Shares beneficially owned by the Kraft Irrevocable Family Trust (with respect to which Mr. Robert K. Kraft disclaims beneficial interest), and 275,000 Ordinary Shares owned by Kraft Group (of which Mr. Robert K. Kraft is the President of the managing member and an indirect holder of membership interests). See footnote 14 above.
- (17) Includes 26,250 Ordinary Shares beneficially owned by Mr. Richard P. Morse (25,000 of which Mr. Robert K. Kraft has the right to vote pursuant to an agreement between Messrs. Morse and Kraft), 52,500 Ordinary Shares owned by the Kraft Foundation (of which Mr. Robert K. Kraft, Mrs. Myra H. Kraft and Mr. Richard A. Karelitz are Trustees with shared investment and voting authority) and 26,250 Ordinary Shares beneficially owned by the Kraft Irrevocable Family Trust (of which Mr. Morse is a Trustee, but with respect to which Mr. Robert K. Kraft, Mrs. Myra H. Kraft and Mr. Morse disclaim beneficial interest, and as to 6,562 Ordinary Shares of which Mr. Jonathan A. Kraft is the beneficiary). Also includes 275,000 Ordinary Shares owned by Kraft Group (of which Mr. Kraft is the President of the managing member and an indirect holder of membership interests; and Mrs. Myra H. Kraft and Mr. Jonathan A. Kraft are indirect holders of membership interests). See footnote 14 above.

The Company acquired at the end of 2000 through Tri-Wall, its subsidiary, 109,400 ordinary shares from two shareholders for a total amount of \$875,200. Together with its formerly held 10,413 shares, Tri-Wall now holds 119,813 shares (4.75% of our total shares), including 157 shares held in trust on behalf of one current employee pursuant to terms of our 1986 Stock Purchase Plan.

B. RELATED PARTY TRANSACTIONS.

In the ordinary course of our business, in 2001, 2002 and 2003 we purchased all of our supply of Israeli produced paper, and 47%, 53% and 48%, respectively, of our overall paper requirements from AIPM, which is a principal shareholder of our company. We believe that such transactions have been on terms no more or less favorable than could have been obtained from unrelated third parties. See notes 4, 9, 10, 15 and 18 of the notes to consolidated financial statements appearing elsewhere herein.

In October 1988, we entered into a ten-year agreement with IFPC, an affiliate of Robert K. Kraft and Rand-Whitney, pursuant to which IFPC undertook to cause Rand-Whitney to provide technical and marketing know-how and assistance to our company. This agreement was approved at a time when no members of our board of directors were affiliated with IFPC or Rand-Whitney. The material terms of the agreement, as they relate to IFPC's and Rand-Whitney's rights and obligations with regard to our company, are as follows: we are entitled to call upon the technical and marketing expertise of Rand-Whitney for advice and assistance, by telephone, telex or in person, from time to time, as determined by us. The assistance is to be provided on the most favorable terms possible, and the compensation for such assistance is to be limited to reimbursement for out-of-pocket costs and expenses incurred by Rand-Whitney. As part of such agreement, IFPC agreed to supply up to 80% of our imported paper and forest products requirements, pursuant to a ten-year right of first refusal, in the ordinary course of our business and on a competitive basis.

On March 9, 1998, we and IFPC agreed to extend the initial period of the supply agreement for an additional ten years through October 2008. This extension was duly approved by our Audit Committee and our Board of Directors in March 1998.

During each of 2001, 2002 and 2003, we purchased 47%, 49% and 24% respectively, of our imported paper supply (in terms of cost) from IFPC. We intend to make future purchases from IFPC on a competitive basis, in our best interests.

C. INTERESTS OF EXPERTS AND COUNSEL.

Not applicable.

ITEM 8. FINANCIAL INFORMATION.

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION.

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

LEGAL PROCEEDINGS

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In 1993, Tri-Wall brought a claim against Rav Kol-Bo Tagar (Wechselman) Ltd., or Kol-Bo, the party from which Tri-Wall sub-leased its facility and property in Netanya, Israel. Tri-Wall's claim sought to enforce its option to acquire the Netanya facility and property, or the Netanya Property, in accordance with a sub-lease agreement between Tri-Wall, and Kol-Bo. Kol-Bo subsequently filed a counter-claim against Tri-Wall, which, together with Tri-Wall's claim, was submitted to arbitration. In May 1994, the arbitrator ruled in favor of Tri-Wall and Kol-Bo appealed the ruling to the District Court in Tel Aviv, Israel. On January 10, 2000, the District Court ruled that Tri-Wall had the right to exercise an option to purchase the Netanya Property directly from the landowners. Both Kol-Bo and the landowners have appealed that ruling to the Israeli Supreme Court. In March 2000, Tri-Wall notified the landowners of the Netanya Property that Tri-Wall had elected to exercise its option to purchase the Netanya Property. Tri-Wall then delivered the consideration for the purchase of the Netanya Property, as determined in the sub-lease agreement between Tri-Wall and Kol Bo, to the landowners. The landowners rejected Tri-Wall's payment, returned the consideration for the purchase of the Netanya Property to Tri-Wall and, since March 2000, have demanded rental payments from Tri-Wall. After failing to resolve this matter through a mediation process, all parties have submitted their summation to the Israeli Supreme Court. On December 31, 2002 arguments were heard by the Supreme Court. The parties await the court's ruling on the matter.

We do not believe that the outcome of this proceeding will have a material effect on us. See note 13(b) to consolidated financial statements.

In 2002, Tri-Wall was notified by the municipality of Netanya its intention to expropriate, without consideration, approximately 24,000 square feet of the aforementioned property on which Tri-Wall's factory is situated in order to construct a public road. In 2003, the municipality of Netanya expropriated, without consideration, approximately 24,000 square feet of the aforementioned property

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In 2000, a lawsuit was filed against us by relatives of a former employee who was insured by a special insurance policy, known as manager's insurance. Such relatives claim loss of income resulting from the fact that such former employee was insured by manager's insurance rather than a pension plan. In December 2002, we reached a settlement of this claim, the terms of which require us to pay a total of NIS 80,000 (\$17,000).

On July 29, 2001, several employees of C.D. filed a lawsuit against C.D. for the payment of a holiday bonus in the aggregate amount of NIS 842,000 (\$190,700). C.D. has set aside the necessary reserves in its financial statements pursuant to the advice of counsel. See note 13(c) to consolidated financial statements.

On December 8, 2002, the Investment Center retroactively cancelled C.D.'s approved enterprise status which was granted to C.D. in 1992. As a result, C.D. is required to refund certain grants in the amount of \$400,000 to be paid in 36 equal monthly installments commencing August 2002. C.D. has committed to employ a certain number of employees, as determined by the Investment Center, until July 2005.

B. SIGNIFICANT CHANGES.

Except as otherwise disclosed in this annual report, there has been no material change in our financial position since December 31, 2003.

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ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS.

The following table sets forth the high and low closing sale prices of our ordinary shares as reported by the American Stock Exchange for the calendar periods indicated:

	PRICE PER ORDINARY SHARE	

	HIGH	LOW
	----	---
1999		
January 1 - March 31.....	6.13	5.12
April 1 - June 30.....	7.50	5.87
July 1 - September 30.....	8.75	7.50
October 1 - December 31.....	8.87	6.62
2000		
January 1 - March 31.....	9.75	8.12
April 1 - June 30.....	8.81	7.75
July 1 - September 30.....	8.50	6.88
October 1 - December 31.....	6.88	4.75

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	PRICE PER ORDINARY SHARE	

	HIGH	LOW
	----	---
2001		
January 1 - March 31.....	5.60	4.62
April 1 - June 30.....	5.20	4.70
July 1 - September 30.....	5.20	4.90
October 1 - December 31.....	5.20	4.90
2002		
January 1 - March 31.....	5.40	4.80
April 1 - June 30.....	6.05	5.35
July 1 - September 30.....	5.50	4.35
October 1 - December 31.....	4.35	3.50
2003		
January 1 - March 31.....	4.20	3.50
April 1 - June 30.....	4.30	4.00
July 1 - September 30.....	5.10	3.50
October 1 - December 31.....	3.70	2.70
2004		
January 1 - January 31.....	4.00	3.50
February 1 - February 28.....	4.10	3.80
March 1 - March 31.....	4.20	4.20
April 1 - April 30.....	4.19	3.85
May 1 - May 31.....	9.70	4.09

B. PLAN OF DISTRIBUTION.

Not applicable.

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C. MARKETS.

Since our initial public offering in 1986, our ordinary shares have traded on the American Stock Exchange under the symbol "KML."

D. SELLING SHAREHOLDERS.

Not applicable.

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E. DILUTION.

Not applicable.

F. EXPENSES OF THE ISSUE.

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL.

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION.

The following is a summary description of certain provisions of our Memorandum of Association and Articles of Association:

OBJECTIVE

Our objective, as stated in our Memorandum of Association, is primarily the manufacturing, processing, recycling and marketing of all types of paper and paper-based related products.

OUR BOARD OF DIRECTORS

The Companies Law requires that certain transactions, actions and arrangements be approved as provided for in a company's articles of association and in certain circumstances by the audit committee and by the board of directors itself. Those transactions that require such approval pursuant to a company's articles of association must be approved by its board of directors. In certain circumstances, audit committee and shareholder approval also is required. The vote required by the audit committee and the board of directors for approval of such matters, in each case, is a majority of the disinterested directors participating in a duly convened meeting. Under the Companies Law, the audit committee is to be comprised of at least three members appointed by the board of directors, which members must include all of the external directors, but excluding the chairman of the board of directors, a general manager, the chief executive officer, a controlling shareholder and any director employed by the company or who provides services to the company on a regular basis.

The Companies Law requires that a member of the board of directors or senior management of the company promptly disclose any personal interest that he or she may have (either directly or by way of any corporation in which he or she is, directly or indirectly, a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager) and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In

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addition, if the transaction is an extraordinary transaction (that is, a transaction other than in the ordinary course of business, otherwise than on market terms, or is likely to have a material impact on the company's profitability, assets or liabilities), the member of the board of directors or senior management must also disclose any personal interest held by his or her spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing.

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Once the member of the board of directors or senior management complies with the above disclosure requirement, a company may approve the transaction in accordance with the provisions of its articles of association. If the transaction is with a third party in which the member of the board of directors or senior management has a personal interest, the approval must confirm that the transaction is not adverse to the company's interest. Furthermore, if the transaction is an extraordinary transaction, then, in addition to any approval stipulated by the articles of association, it also must be approved by the company's audit committee and then by the board of directors, and, under certain circumstances, by a meeting of the shareholders of the company.

Our articles of association provide that, subject to the provisions of Companies Law, our directors may enter into business transactions with us or be a party to any transaction in which we are interested, so long as the interested director discloses to the remaining directors the nature and extent of his material interest. Subject to certain limited exceptions, a director may not vote on any resolution concerning a matter in which he has, directly or indirectly, a material interest. Our shareholders have the power, however, to suspend, either generally or with respect to a specific matter, any provision of our articles of association that prohibit a director from voting on a certain matter.

Our directors are entitled to such remuneration that, pursuant to an ordinary resolution, our shareholders determine to pay them. We do not impose an age-limit requirement with respect to retirement of our directors, and they are not required to hold any qualification shares.

DESCRIPTION OF SECURITIES

We are authorized to issue 10,000,000 ordinary shares, NIS 1.0 par value per share.

The ordinary shares do not have preemptive rights. Neither our memorandum of association or articles of association nor the laws of the State of Israel restrict the ownership or voting of ordinary shares by non-residents of Israel, except for subjects of countries which are enemies of Israel.

Subject to the Companies Law, we may declare dividends, pursuant to ordinary resolution, in accordance with the respective rights of our shareholders, but no dividend shall exceed the amount recommended by our directors. Dividends may be payable in assets. No dividend or other moneys payable in respect of a share shall bear interest against us unless otherwise provided by the rights attached to the share. Any dividend that has remained unclaimed for 12 years from the date when it became due for payment shall, if our directors so resolve, be forfeited and cease to remain owing by us.

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Upon our liquidation, the liquidator may, pursuant to an

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extraordinary resolution of our shareholders and any other approval required by law, divide among our shareholders the whole or any part of our assets and may, for that purpose, value any assets and determine how the division shall be carried out as between our shareholders or different classes of them. The liquidator may vest the whole or any part of the assets in trustees, upon such trusts for the benefit of our shareholders as he determines, but no shareholder shall be compelled to accept any assets upon which there is a liability.

Subject to any rights or restrictions attached to any shares, each shareholder is entitled to one vote for each ordinary share held on all matters submitted to a vote of shareholders. All general shareholder meetings other than annual general shareholder meetings shall be called extraordinary general meetings. Our directors may call general shareholder meetings and, at the request of our shareholders pursuant to the provisions of the Companies Law, will convene an extraordinary general meeting, for a date not later than eight weeks after receipt of the request. If there are not sufficient directors to call a general meeting located in Israel, any director or any of our shareholders may call a general meeting.

Subject to the terms of allotment, our directors may make calls upon our shareholders in respect of any moneys unpaid on their shares (whether in respect of nominal value or premium), and each shareholder shall (subject to receiving at least 14 days' notice specifying when and where payment is to be made) pay to us as required by the notice the amount called on his shares. A call may be required to be paid by installments. A call may, before receipt by us of any sum due thereunder, be revoked in whole or part, and payment of a call may be postponed in whole or part. A person upon whom a call is made shall remain liable for calls made upon him, notwithstanding the subsequent transfer of the shares in respect whereof the call was made.

If at any time our shares are divided into different classes, the rights attached to any class, unless otherwise provided by the terms of issue of the shares of that class, may be modified, abrogated or otherwise dealt with by us, with the consent in writing of the holders of 75% of the issued shares of that class or pursuant to a special resolution passed at a separate general meeting of the holders of the shares of that class.

There are no limitations imposed by our Articles of Association or the Companies Law with respect to the right to own our shares, including the rights of non-resident or foreign shareholders to hold or exercise voting rights of our shares.

Certain provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger or other acquisition of our company, but there are no such provisions in our Articles of Association.

C. MATERIAL CONTRACTS.

On January 1, 2003, we signed an agreement pursuant to which we would purchase all of the shares of Best Carton Ltd. ("Best") from the shareholders of Best. Pursuant to the terms of the agreement, in consideration for such Best shares, we would issue to Best's shareholders such number of newly-issued ordinary shares of our company as would constitute 27.9% of the outstanding ordinary shares of our company (excluding dormant shares) following the issuance. The consummation of this transaction was contingent upon the approval of our shareholders and the authorization of the Supervisor of Restrictive Business Practices in Israel.

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Concurrent with our agreement with Best, Tri-Wall entered into an agreement with Ampal, a member of the controlling group of our company, pursuant to which Tri-Wall will acquire all of Ampal's holdings in our company (522,000 shares, which currently constitute 21.75% of the currently outstanding ordinary shares of Carmel), in consideration for \$6.75 per share in cash. Upon completion of this transaction, the acquired shares would become dormant shares. The consummation of the Tri-Wall/Ampal transaction was contingent upon the consummation of the Carmel/Best transaction and upon obtaining the authorizations required by law.

On May 29, 2003, we were notified that the Supervisor of Restrictive Business Practices in Israel rejected the proposed transaction. We are currently assessing all actions available to us in response to the decision of the Supervisor of Restrictive Business Practices.

D. EXCHANGE CONTROLS.

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under the law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion. Because exchange rates between the NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to the risk of currency fluctuations between the date when we declare NIS-denominated dividends and the date when we pay them in NIS. See "Item 3. Key Information - D. Risk Factors."

E. TAXATION.

Investors are advised to consult their tax own advisors with respect to the tax consequences of their purchases, ownership and sales of ordinary shares, including the consequences under applicable state and local law and federal estate and gift tax law, and the application of foreign laws or the effect of nonresident status on United States taxation. This tax summary does not address all of the tax consequences to the investors of purchasing, owning or disposing of the ordinary shares.

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ISRAELI TAX CONSIDERATIONS

The following is a discussion of Israeli and United States tax consequences material to our shareholders. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not be accepted by the tax authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

TAX REFORM

On January 1, 2003, the Law for Amendment of the Income Tax Ordinance (Amendment No. 132), 5762-2002, known as the Tax Reform, came into effect, following its enactment by the Israeli Parliament on July 24, 2002. On December

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17, 2002, the Israeli Parliament approved a number of amendments to the Tax Reform, which also came into effect on January 1, 2003.

The Tax Reform introduced the following, among other things:

- o Reduction of the tax rate levied on capital gains (other than gains deriving from the sale of listed securities) derived after January 1, 2003, to a general rate of 25% for both individuals and corporations. Regarding assets acquired prior to January 1, 2003, the reduced tax rate will apply to a proportionate part of the gain, in accordance with the holding periods of the asset, before or after January 1, 2003, on a linear basis;
- o Imposition of Israeli tax on all income of Israeli residents, individuals and corporations, regardless of the territorial source of income, including income derived from passive sources such as interest, dividends and royalties;
- o Introduction of controlled foreign corporation (CFC) rules into the Israeli tax structure. Generally, under such rules, an Israeli resident who holds, directly or indirectly, 10% or more of the rights in a foreign corporation whose shares are not publicly traded, in which more than 50% of the rights are held directly or indirectly by Israeli residents, and a majority of whose income in a tax year is considered passive income, will be liable for tax on the portion of such income attributed to his holdings in such corporation, as if such income were distributed to him as a dividend;
- o Imposition of capital gains tax on capital gains realized by individuals as of January 1, 2003 from the sale of shares of publicly traded companies (such gain was previously exempt from capital gains tax in Israel). For information with respect to the applicability of Israeli capital gains taxes on the sale of ordinary shares, see "- Capital Gains Tax on Sales of Our Ordinary Shares" below; and
- o Introduction of a new regime for the taxation of shares and options issued to employees and officers (including directors).

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GENERAL CORPORATE TAX STRUCTURE

Generally, Israeli companies are subject to "Company Tax" at the rate of 36% of taxable income (and are subject to Capital Gains Tax at a rate of 25% for capital gains derived after January 1, 2003). However, the effective tax rate payable by a company which derives income from an approved enterprise (as further discussed below) may be considerably less.

TAX BENEFITS UNDER THE LAW FOR THE ENCOURAGEMENT OF CAPITAL INVESTMENTS, 1959

The Law for the Encouragement of Capital Investments, 1959, as amended (the "Investment Law"), provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Commerce of the State of Israel, be designated as an approved enterprise. The Investment Center bases its decision as to whether or not to approve an application on the criteria set forth in the Investment Law and regulations, the then prevailing policy of the Investment Center and the specific objectives and financial criteria of the applicant. Each certificate of approval for an approved enterprise relates to a specific investment program

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delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program.

The Investment Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs under an amendment to the Investments Law that was made within the framework of the Tax Reform; it was clarified that tax benefits under the Investments Law shall also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise's ordinary course of business. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investment Law are not available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investment Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a CPI linkage adjustment and interest.

The Investment Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Taxable income of a company derived from an approved enterprise is subject to company tax at the maximum rate of 25%, rather than 36%, for the benefit period. This period is ordinarily seven years, commencing with the year in which the approved enterprise first generates taxable income, and is limited to twelve years from commencement of production or 14 years from the date of approval, whichever is earlier.

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A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company in which more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company that qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. As specified below, depending on the geographic location of the approved enterprise within Israel, income derived from the approved enterprise program may be exempt from tax on its undistributed income for a period of between two to ten years, and will be subject to a reduced tax rate for the remainder of the benefits period. The tax rate for the remainder of the benefits period will be 25%, unless the level of foreign investment exceeds 49%, in which case the tax rate will be 20% if the foreign investment is more than 49% and less than 74%; 15% if more than 74% and less than 90%; and 10% if 90% or more.

Instead of the foregoing tax benefits, a company may elect to receive an alternative package of benefits. Under the alternative package of benefits, undistributed income derived from the approved enterprise will be exempt from company tax for a period of between two and ten years from the first year the company derives taxable income under the program, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for a reduced tax rate for the remainder of the benefits period. A company that has elected the alternative package of benefits, such as us, that subsequently pays a dividend out of income derived from the approved enterprise

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during the tax exemption period will be subject to tax in respect of the amount distributed, including any taxes thereon, at the rate which would have been applicable had it not elected the alternative package of benefits, generally 10%-25%, depending on the percentage of the company's ordinary shares held by foreign shareholders. The dividend recipient is taxed at the reduced rate of 15% applicable to dividends from approved enterprises if the dividend is distributed during the tax exemption period or within twelve years thereafter. The company must withhold this tax at source, regardless of whether the dividend is converted into foreign currency.

Subject to applicable provisions concerning income under the alternative package of benefits, dividends paid by a company are considered to be attributable to income received from the entire company, and the company's effective tax rate is the result of a weighted average of the various applicable tax rates, excluding any tax exempt income. Under the Investment Law, a company that has elected the alternative package of benefits is not obliged to distribute retained profits, and may generally decide from which year's profits to declare dividends. We currently intend to reinvest any income derived from our approved enterprise program and not to distribute such income as a dividend.

The Israeli government may reduce or eliminate tax benefits available to approved enterprise programs in the future. We cannot assure you that our approved program and the benefits thereunder shall continue in the future at its current level or at any level. See "Item 3. Key Information -- D. Risk Factors -- We are subject to various risks relating to operations in Israel" and "--Tax Reform" above.

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TAX BENEFITS UNDER THE LAW FOR THE ENCOURAGEMENT OF INDUSTRY (TAXES), 1969

Under the Law for the Encouragement of Industry (Taxes), 1969 (the "Industry Encouragement Law"), Industrial Companies are entitled to the following preferred corporate tax benefits:

- o deduction of purchases of know-how and patents over an eight-year period for tax purposes;
- o right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies; and
- o accelerated depreciation rates on equipment and buildings.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the Industry Encouragement Law, an "Industrial Company" is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is defined as an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. No assurance can be given that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

CAPITAL GAINS TAX ON SALES OF OUR ORDINARY SHARES

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Israeli law generally imposes a capital gains tax on the sale of capital assets located in Israel, including shares in Israeli companies, by both residents and non-residents of Israel, unless a specific exemption is available or a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain which is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the Israeli CPI between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Prior to the Tax Reform, sales of our ordinary shares by individuals were generally exempt from Israeli capital gains tax for so long as they were quoted on the American Stock Exchange or listed on a stock exchange in a country appearing in a list approved by the Controller of Foreign Currency and we qualified as an Industrial Company.

Pursuant to the Tax Reform, generally, capital gains tax is imposed at a rate of 15% on real gains derived on or after January 1, 2003 from the sale of shares in companies, such as ours, whose shares are publicly traded on the Tel Aviv Stock Exchange or on a recognized stock exchange outside of Israel. However, this tax rate does not apply to: (i) dealers in securities; (ii) shareholders that report in accordance with the Inflationary Adjustment Law; or

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(iii) shareholders who acquired their shares prior to an initial public offering (that are subject to a different tax arrangement). The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price. Moreover, non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares publicly traded on the Tel Aviv Stock Exchange or a recognized stock exchange outside of Israel, provided, however, that such capital gains are not derived from a permanent establishment in Israel and provided that such shareholders did not acquire their shares prior to an initial public offering. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In any event, the provisions of the Tax Reform shall not effect the exemption from capital gains tax for gains accrued before January 1, 2003, as described above.

In some instances where our shareholders may be liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source. Pursuant to the Convention between the government of the United States of America and the government of Israel with Respect to Taxes on Income, as amended, or the U.S.-Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty generally will not be subject to the Israeli capital gains tax unless such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions. In this case, the sale, exchange or disposition of ordinary shares

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would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

TAXATION OF NON-RESIDENT HOLDERS OF SHARES

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income, such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends other than bonus shares, or stock dividends, income tax at the rate of up to 25% is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 25%. However, under the Investment Law, dividends generated by an approved enterprise are taxed at the rate of 15%. Furthermore, dividends not generated by an approved enterprise paid to a U.S. company holding 10% or more of our ordinary shares are taxed at a rate of 12.5%.

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Under an amendment to the Inflationary Adjustments Law, non-Israeli corporations might be subject to Israeli taxes on the sale of traded securities in an Israeli company, subject to the provisions of any applicable double taxation treaty or unless a specific exemption is available.

For information with respect to the applicability of Israeli capital gains taxes on the sale of ordinary shares by United States residents, see "-- Capital Gains Tax on Sales of Our Ordinary Shares" above.

EXCHANGE CONTROLS

FOREIGN EXCHANGE REGULATIONS

Dividends (if any) paid to the holders of our ordinary shares, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion.

UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

Subject to the limitations described herein, the following discussion summarizes the material United States federal income tax consequences to a U.S. Holder of our ordinary shares. A "U.S. Holder" means a holder of our ordinary shares who is:

- o a citizen or resident of the United States;
- o a corporation (or other entity taxable as a corporation) created or organized in the United States or under the laws of the United States or any political subdivision thereof;
- o an estate, the income of which is subject to United States federal income tax regardless of its source; or
- o a trust, (i) if, in general a court within the United States is

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able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions, or (ii) that has in effect a valid election under applicable U.S. Treasury regulations to be treated as a U.S. person.

This discussion considers only U.S. Holders that will own their ordinary shares as capital assets and does not purport to be a comprehensive description of all of the tax considerations that may be relevant to each person's decision to purchase ordinary shares.

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This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended, or the Code, current and proposed Treasury regulations promulgated thereunder and administrative and judicial decisions as of the date hereof, all of which are subject to change, possibly on a retroactive basis. Under current consideration are various legislative proposals under which, among other things, certain dividends would be excluded from income and individual income tax rates on ordinary income would be reduced. It is not clear at this time whether, or in what form, any of such legislative proposals (or other proposals) will be enacted, what the effective date of any such changes would be and what other changes would be made that could further affect the tax consequences discussed herein. This discussion does not address all aspects of United States federal income taxation that may be relevant to any particular U.S. Holder in light of such U.S. Holder's individual circumstances. In particular, this discussion does not address the potential application of the alternative minimum tax or United States federal income tax consequences to shareholders that are subject to special treatment, including U.S. Holders that:

- o are broker-dealers or insurance companies;
- o have elected mark-to-market accounting;
- o are tax-exempt organizations or retirement plans;
- o are financial institutions or "financial services entities;"
- o hold ordinary shares as part of a straddle, "hedge" or "conversion transaction" with other investments;
- o acquired their shares upon the exercise of employee stock options or otherwise as compensation;
- o hold their shares through partnerships or other pass-through entities;
- o own directly, indirectly or by attribution at least 10% of our voting power; or
- o have a functional currency that is not the U.S. dollar.

In addition, this discussion does not address any aspect of state, local or non-United States tax laws or the possible application of United States federal gift or estate tax.

EACH HOLDER OF ORDINARY SHARES IS ADVISED TO CONSULT SUCH PERSON'S OWN TAX ADVISOR WITH RESPECT TO THE SPECIFIC TAX CONSEQUENCES TO SUCH PERSON OF PURCHASING, HOLDING OR DISPOSING OF OUR ORDINARY SHARES, INCLUDING THE APPLICABILITY AND EFFECT OF FEDERAL, STATE, LOCAL AND FOREIGN INCOME TAX AND OTHER TAX LAWS IN SUCH PERSON'S PARTICULAR CIRCUMSTANCES.

TAXATION OF ORDINARY SHARES

Taxation of Dividends Paid on Ordinary Shares. A U.S. Holder will be required to include in gross income as ordinary dividend income the amount of any distribution paid on ordinary shares, including any Israeli taxes withheld from the amount paid, on the date the distribution is received to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for United States federal income tax purposes. Distributions in excess of such earnings and profits will be applied against and will reduce the U.S. Holder's basis in our ordinary shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of our ordinary shares. The dividend portion of such distributions generally will not qualify for the dividends received deduction available to corporations.

Distributions of current or accumulated earnings and profits paid in foreign currency to a U.S. Holder (including any Israeli taxes withheld therefrom) will be includible in the income of a U.S. Holder in a U.S. dollar amount calculated by reference to the exchange rate on the day the distribution is received. A U.S. Holder that receives a foreign currency distribution and converts the foreign currency into U.S. dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

U.S. Holders will have the option of claiming the amount of any Israeli income taxes withheld at source either as a deduction from gross income or as a dollar-for-dollar credit against their United States federal income tax liability. Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the Israeli income taxes withheld, but such amount may be claimed as a credit against the individual's United States federal income tax liability. The amount of foreign income taxes which may be claimed as a credit in any year is subject to complex limitations and restrictions, which must be determined on an individual basis by each shareholder. These limitations include, among others, rules which limit foreign tax credits allowable with respect to specific classes of income to the United States federal income taxes otherwise payable with respect to each such class of income. The total amount of allowable foreign tax credits in any year cannot exceed regular U.S. tax liability for the year attributable to foreign source taxable income. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from a dividend received on the ordinary shares if such U.S. Holder has not held the ordinary shares for at least 16 days of the 30-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend, or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16-day holding period. Distributions of current or accumulated earnings and profits will be foreign source passive income for United States foreign tax credit purposes.

Taxation of the Disposition of Ordinary Shares. Upon the sale, exchange or other disposition of our ordinary shares, a U.S. Holder will recognize capital gain or loss in an amount equal to the difference between such U.S. Holder's basis in such ordinary shares, which is usually the cost of such shares, and the amount realized on the disposition. A U.S. Holder that uses the

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cash method of accounting calculates the U.S. dollar value of the proceeds received on the sale as of the date that the sale settles, while a U.S. Holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the "trade date," unless such U.S. Holder has elected to use the settlement date to determine its proceeds of sale. Capital gain from the sale, exchange or other disposition of ordinary shares held more than one year is long-term capital gain, and is eligible for a reduced rate of taxation for individuals. Gains recognized by a U.S. Holder on a sale, exchange or other disposition of ordinary shares will be treated as United States source income for United States foreign tax credit purposes. A loss recognized by a U.S. Holder on the sale, exchange or other disposition of ordinary shares is allocated to U.S. source income. The deductibility of a capital loss recognized on the sale, exchange or other disposition of ordinary shares is subject to limitations. A U.S. Holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into U.S. dollars subsequent to the settlement date or trade date (whichever date the taxpayer was required to use to calculate the value of the proceeds of sale) will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the U.S. dollar, which will generally be U.S. source ordinary income or loss.

TAX CONSEQUENCES FOR NON-U.S. HOLDERS OF ORDINARY SHARES

Except as described in "-- Information Reporting and Back-Up Withholding" below, a non-U.S. Holder of ordinary shares will not be subject to U.S. federal income or withholding tax on the payment of dividends on, and the proceeds from the disposition of, ordinary shares, unless:

- o such item is effectively connected with the conduct by the non-U.S. Holder of a trade or business in the United States and, in the case of a resident of a country which has a treaty with the United States, such item is attributable to a permanent establishment or, in the case of an individual, a fixed place of business, in the United States;
- o the non-U.S. Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and does not qualify for an exemption; or
- o the non-U.S. Holder is subject to tax pursuant to the provisions of United States tax law applicable to U.S. expatriates.

INFORMATION REPORTING AND BACK-UP WITHHOLDING

U.S. Holders generally are subject to information reporting requirements with respect to dividends paid in the United States on ordinary shares. Under the Code, a U.S. Holder may be subject, under certain circumstances, to backup withholding at a rate of up to 28% with respect to dividends paid on our ordinary shares unless the holder provides proof of an applicable exemption or correct taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules.

A holder of ordinary shares who does not provide a correct taxpayer identification number may be subject to penalties imposed by the IRS. Amounts withheld under the backup withholding rules are not an additional tax and may be refunded or credited against the holder's federal income tax liability, provided the required information is furnished to the IRS.

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Non-U.S. Holders generally are not subject to information reporting or back-up withholding with respect to dividends paid on, or the proceeds from the disposition of, ordinary shares, provided that such non-U.S. Holder provides a taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

F. DIVIDENDS AND PAYING AGENTS.

Not applicable.

G. STATEMENTS BY EXPERTS.

Not applicable.

H. DOCUMENTS ON DISPLAY.

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), applicable to foreign private issuers and fulfill the obligation with respect to such requirements by filing reports with the Securities and Exchange Commission. You may read and copy any document we file with the Securities and Exchange Commission without charge at the Securities and Exchange Commission's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Branch of the Securities and Exchange Commission at such address, at prescribed rates. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the Securities and Exchange Commission as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices.

I. SUBSIDIARY INFORMATION.

Not applicable.

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ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

FOREIGN CURRENCY RISK

Our operating expenses are influenced by changes in the exchange rates between the NIS and foreign currencies, especially the U.S. dollar. Our financial expenses increase when the NIS is devalued against such currencies. At December 31, 2003, our monetary liabilities linked to the dollar amounted to NIS 42.0 million (\$9.6 million). In 2003, our monetary liabilities denominated in foreign currencies represented 26.4% of our total financial liabilities, compared to NIS 57.3 million, amounting to 34.1% of the financial liabilities, in 2002. Our financial assets in 2003 linked to foreign currency were NIS 2.1 million (\$0.5 million), compared to NIS 1.9 million in 2002. See note 17 to our consolidated financial statements.

In the ordinary course of our operations, we purchase option

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contracts to hedge our net exposures, by currency, related to the foreign currency and to the Israeli CPI denominated monetary assets and liabilities of our operations. We do not use derivative financial instruments for speculative or trading purposes. The dollar amount underlying such derivative financial instruments at December 31, 2003 was NIS 5.0 million (\$1.1 million), compared to NIS 3.5 million at December 31, 2002. These transactions were valid until March 2004, and the expenses associated therewith were not large enough to affect our operating results. We paid a premium of 1.34% for 90-day option warrants. To hedge our net exposures to an increase in the Israeli CPI, we purchased a derivative instrument which has since expired.

As of December 31, 2003, we had NIS 1.5 million (\$0.3 million) of debt linked to the Israeli CPI, amounting to 0.9% of our financial liabilities in the year 2003, compared with NIS 6.1 million, which amounted to 3.6% of our financial liabilities as of December 31, 2002.

Despite our hedging transactions, our outstanding financial liabilities at December 31, 2003 are exposed to exchange rate differentials. Based on the volume of the foreign currency liabilities described above, a 5% rise in the exchange rate may lead to additional financial expenses of NIS 2.0 million (\$0.5 million).

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.

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ITEM 15. CONTROLS AND PROCEDURES

(a) Within 90 days prior to the filing date of this Annual Report on Form 20-F, we have carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in assuring that all material information relating to our company is made known to them.

(b) There have been no significant changes in our internal controls or in other factors, which could significantly affect the internal controls subsequent to the date of their evaluation in connection with the preparation of this Annual Report on Form 20-F.

ITEM 16. (RESERVED)

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board has determined that Israel Eldar is an audit committee financial expert serving on its Audit Committee.

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ITEM 16B. CODE OF ETHICS

A Code of Ethics has been drafted and will be presented at the next meeting of the Board of Directors.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The table below summarizes the audit fees paid (in thousands of NIS) by the Company and its consolidated subsidiaries during each of 2002 and 2003.

FEES	2002	2003
Audit Fees	280	278
Tax Fees (18)	90	90

(18) "Tax Fees" are fees for professional services rendered by the Company's auditors for tax compliance, tax advice on actual or contemplated transactions and tax consulting.

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AUDIT COMMITTEE'S PRE-APPROVAL POLICIES AND PROCEDURES

The auditors provided no other services than audit work and preparation of tax returns in the ordinary course of business. For fiscal 2003 and in previous years, the principal accountants' services were preapproved by the Company's shareholders at the Annual General Meeting of Shareholders, pursuant to Israeli law. The Audit Committee's rules of procedure provided for this process with respect to the prior approval at the General Meeting of all services to be performed by the principal accountants. In fiscal 2003, all of the services provided by the principal accountants were preapproved at the General Meeting before May 15, 2003.

The Company will follow the procedures outlined below for fiscal 2004 and future years. The Audit Committee of the Company's board of directors will choose and engage the Company's independent auditors to audit the Company's financial statements. The Company's Audit Committee will adopt a policy requiring management to obtain the Audit Committee's approval before engaging the Company's independent auditors to provide any audit or permitted non-audit services to the Company or its subsidiaries. This policy, which is designed to assure that such engagements do not impair the independence or the Company's auditors, will require the audit committee to pre-approve various audit and non-audit services that may be performed by the Company's auditors. In addition, the audit committee will limit the aggregate amount of fees the Company's auditors may receive during 2004 for non-audit services in certain categories. The Company's Chief Financial Officer will review all management requests to engage the Company's auditors to provide services and will approve the request if the requested services are of the type pre-approved by the audit committee. The Company will inform the audit committee of these approvals at least quarterly. Services of the type not pre-approved by the audit committee will require pre-approval by the audit committee on a case-by-case basis. The audit committee will not be permitted to approve the engagement of the Company's auditors for any services that fall into a category of services that is not permitted by applicable law or if the services would be inconsistent with

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maintaining the auditor's independence.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

We have not applied for any exemptions from the listing standards for the audit committee to date.

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

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of this item.

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ITEM 18. FINANCIAL STATEMENTS

The financial statements required by this item are found at the end of this annual report, beginning on page F-1.

ITEM 19. EXHIBITS

The exhibits filed with or incorporated into this annual report are listed on the index of exhibits below:

EXHIBIT NO. ---	DESCRIPTION -----
1.1	Memorandum of Association*
1.2	Articles of Association*
4.1	Carmel Container Systems Ltd. 1999 Senior Employee Stock Option Plan **
8	Subsidiaries of Carmel Container Systems, Ltd.***
12.1	Certification pursuant to Rule 13a-14(a) of the Exchange Act by Doron Kempler****
12.2	Certification pursuant to Rule 13a-14(a) of the Exchange Act by Nestor Szwarcberg****
13.1	Certification pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350 by Doron Kempler****
13.2	Certification pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350 by Nestor Szwarcberg****

* Incorporated herein by reference to our Registration Statement on Form F-1 (Registration No. 3308150).

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- ** Incorporated herein by reference to our Registration Statement of Form S-8 (Registration No. 333-10002).
- *** Incorporated herein by reference to our annual report on Form 20-F for the year ended December 31, 2000.
- **** Filed herewith.

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CARMEL CONTAINER SYSTEMS LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2003

ADJUSTED TO THE NIS OF DECEMBER 2003

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[Ernst & Young]

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REPORT OF INDEPENDENT AUDITORS

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TO THE SHAREHOLDERS OF
CARMEL CONTAINER SYSTEMS LTD.

We have audited the accompanying consolidated balance sheets of Carmel Container Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2002 and 2003, and the related consolidated statements of operations, 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 management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of subsidiaries whose assets included in the consolidation constitute approximately 10% and 10% of total consolidated assets as of December 31, 2002 and 2003, respectively, and whose revenues included in the consolidation constitute approximately 29%, 9% and 9% of total consolidated revenues for the years ended December 31, 2001, 2002 and 2003, respectively. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those subsidiaries is based on the report of the other auditors. The financial statements for the year ended December 31, 2001 of one of the subsidiaries referred to above whose revenues included in the consolidation constitute approximately 19% of total consolidated revenues for the years ended December 31, 2001, were audited by Luboshitz Kasierer, a member of Andersen Worldwide, who issued an unqualified opinion in their report dated January 28, 2002. Andersen Worldwide has ceased operating as a member of the Securities and Exchange Commission Practice Section of the American Institute of Certified Public Accountants.

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

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In our opinion, based on our audit and the reports of other 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, 2002 and 2003, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in Israel, which differ in certain respects from accounting principles generally accepted in the United States (see Note 21 to the consolidated financial statements).

Tel-Aviv, Israel
March 9, 2004

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ADJUSTED TO THE NIS OF DECEMBER 2003

	DECEMBER 31	2002	ADJUSTED
			(IN THOUSANDS)
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		636	
Trade receivables, (net of allowance for doubtful debts of adjusted NIS 2,468 and adjusted NIS 2,241 (\$ 514) at December 31, 2002 and 2003, respectively) (Note 3)		119,069	
Other accounts receivable and prepaid expenses (Note 4)		4,104	
Inventories (Note 5)		48,937	

Total current assets		172,746	

PROPERTY AND EQUIPMENT, NET (Note 6)		128,060	

Total assets		300,806	
		=====	

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ADJUSTED TO THE NIS OF DECEMBER 2003

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	DECEMBER
	2002
	ADJUSTED
	(IN THOUSANDS,
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Short-term credit from banks and others (Note 8)	10,204
Current maturities of long-term loans and capital lease obligations (Note 11)	30,647
Trade payables (Note 9)	74,578
Other accounts payable and accrued expenses (Note 10)	15,522

Total current liabilities	130,951

LONG-TERM LIABILITIES:	
Long-term loans from banks and others (Note 11)	29,548
Capital lease obligations (Note 11)	7,442
Accrued severance pay, net (Note 12)	470
Deferred income taxes (Note 16g)	7,813

Total long-term liabilities	45,273

CONTINGENT LIABILITIES AND COMMITMENTS (Note 13)	
MINORITY INTEREST IN A SUBSIDIARY	
	11,128

SHAREHOLDERS' EQUITY (Note 15):	
Share capital - Ordinary shares of NIS 1.0 par value: 10,000,000 authorized at December 31, 2002 and 2003; 2,520,000 shares issued and outstanding at December 31, 2002 and 2003	23,716
Additional paid-in capital	45,413
Retained earnings	48,583

	117,712
Less - shares held by subsidiary	4,258

Total shareholders' equity	113,454

Total liabilities and shareholders' equity	300,806
	=====

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

ADJUSTED TO THE NIS OF DECEMBER 2003

	YEAR ENDED DECEMBER 31,		
	2001	2002	2003
	ADJUSTED NIS		
	(IN THOUSANDS, EXCEPT SHARE)		
Revenues from sales, net (Note 20)	350,031	337,633	340,000
Cost of revenues (Note 19a)	316,328	311,238	311,000
Gross profit	33,703	26,395	33,000
Selling and marketing expenses (Note 19b)	18,072	16,759	18,000
General and administrative expenses (Note 19c)	19,459	17,688	19,000
	37,531	34,447	37,000
Operating income (loss)	(3,828)	(8,052)	(4,000)
Financial expenses, net (Note 19d)	(10,862)	(6,078)	(11,000)
Other income (expenses), net (Note 19e)	(14,690) 152	(14,130) (1,155)	(15,000) (1,000)
Loss before tax benefit	(14,538)	(15,285)	(16,000)
Tax benefit (Note 16)	(5,567)	(5,926)	(6,000)
Loss after tax benefit	(8,971)	(9,359)	(10,000)
Minority interest in losses of a subsidiary	232	807	0
Net loss	(8,739)	(8,552)	(10,000)

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Basic and diluted net loss per NIS 1 par value of shares (in adjusted NIS)	(3.64)	(3.56)	=====
Weighted average number of shares outstanding during the year (in thousands)	2,400	2,400	=====

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

ADJUSTED TO THE NIS OF DECEMBER 2003

	SHARE CAPITAL -----	ADDITIONAL PAID-IN CAPITAL -----	RETAINED EARNINGS ----- ADJUSTED NIS (IN THOUSANDS)
Balance at January 1, 2001	23,716	45,413	65,874
Net loss	-	-	(8,739)
Balance at December 31, 2001	23,716	45,413	57,135
Net loss	-	-	(8,552)
Balance at December 31, 2002	23,716	45,413	48,583
Net loss	-	-	(1,843)
Balance at December 31, 2003	23,716	45,413	46,740

CONVENIENCE TRANSLATION INTO U.S.

			(IN THOUSANDS)
Balance at December 31, 2003	5,416	10,371	10,675

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

ADJUSTED TO THE NIS OF DECEMBER 2003

	YEAR ENDED DECEMBER	
	2001	2002
	-----	-----
	ADJUSTED NET CASH (IN THOUSAND DOLLARS)	
Cash flows from operating activities:		

Net loss	(8,739)	(8,552)
Adjustments required to reconcile net loss to net cash provided by operating activities:		
Losses on investment in a subsidiary	-	-
Minority interest in losses of a subsidiary	(232)	(807)
Depreciation	26,786	25,567
Deferred income taxes, net	(5,567)	(6,257)
Accrued severance pay, net	(404)	484
Capital loss (gain) on sale of property and equipment, net	(152)	(156)
Erosion (increase in value) of long-term loans from banks and others and capital lease obligations	(137)	(3,865)
Other		
Decrease (increase) in trade receivables	16,612	(10,599)
Decrease (increase) in other accounts receivable and prepaid expenses	695	(828)
Decrease in inventories	10,791	5,016
Increase (decrease) in trade payables	(1,501)	17,368
Increase (decrease) in other accounts payable and accrued expenses	(3,491)	372
	-----	-----
Net cash provided by operating activities	34,661	17,743
	-----	-----
Cash flows from investing activities:		

Proceeds from acquisition of subsidiary consolidated for the first time, net (1)	-	-

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Purchase of property and equipment	(10,587)	(2,385)
Proceeds from sale of property and equipment	662	749
Refund of an investment grant	-	(253)
	-----	-----
Net cash used in investing activities	(9,925)	(1,889)
	-----	-----
Cash flows from financing activities:		
	-----	-----
Proceeds from long-term loans from banks and others	15,669	9,960
Principal payments of long-term loans from banks and others	(20,015)	(24,072)
Principal payments of loans from a related party	(1,875)	-
Short-term credit from bank and others, net	(18,538)	(1,587)
	-----	-----
Net cash provided by (used in) financing activities	(24,759)	(15,699)
	-----	-----
Increase (decrease) in cash and cash equivalents	(23)	155
Cash and cash equivalents at beginning of year	504	481
	-----	-----
Cash and cash equivalents at end of year	481	636
	=====	=====
a. Non-cash transactions:		
	-----	-----
Liability in respect of an investment grant refund	-	1,572
	=====	=====
b. Supplemental disclosure of cash flows activities:		
	-----	-----
Cash paid during the year for:		
Interest	8,724	7,231
	=====	=====
Income taxes	22	28
	=====	=====

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

ADJUSTED TO THE NIS OF DECEMBER 2003

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	YEAR ENDED DECEMBER	
	2001	2002
	ADJUSTED NIS	
	(IN THOUSANDS)	
(1) Proceeds from acquisition of subsidiary consolidated for the first time: Working capital, net	-	-
	=====	=====

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

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: - GENERAL

a. Carmel Container Systems Ltd. ("Carmel Systems" or "the Company"), is an Israeli industrial company. The Company and its subsidiaries ("the Group") designs, manufactures and markets shipping containers, consumer packaging products and packaging wooden pallets and boxes (see Note 20). The Group's sales are to a large number of customers mainly in Israel.

b. Definitions:

In these financial statements:

Subsidiaries - Companies in which more than 50% of the voting equity is owned or controlled by the Company (as defined in Opinion 57 of the Institute of Certified Public Accountants in Israel) and whose accounts are consolidated with those of the Company.

Related parties - Parties who own 10% or more of the voting equity of the Company; as defined in Opinion 29 of the Institute of Certified Public Accountants in Israel.

c. Investment in Solid Board Ltd

Solid Packaging Board Ltd. (Solid) was incorporated and commenced its operations in 1995. CD Packaging Systems Ltd. (CD) and KAPPA Packaging

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International BV (KAPPA) each jointly held 50% of Solid's shares. On November 24, 2003, CD and KAPPA signed an agreement, according to which, CD acquired, the shares held by KAPPA. In addition, KAPPA has forgiven Solid on a loan that was due to KAPPA in the amount of adjusted NIS 82 thousand. In exchange for acquisition of KAPPA's shares in Solid, KAPPA has paid CD NIS 148 thousand. In December 2003, the operations of Solid were transferred to CD and Solid became inactive. Prior to November 24, 2003, the financial statements of Solid were consolidated into CD's financial statements in accordance with the proportionate consolidation method. As of December 31, 2003, the financial statements of Solid were fully consolidated with CD's financial statements.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements presented herein are prepared in accordance with generally accepted accounting principles ("GAAP") in Israel, which differ in certain respects from those followed in the United States, as described in Note 21.

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in adjusted New Israeli Shekels:

1. The Group maintains its accounting records in nominal New Israeli Shekels (NIS). In accordance with the Statements of the Institute of Certified Public Accountants in Israel, all the amounts in the financial statements (including comparative figures) are presented in adjusted NIS, which have a constant purchasing power. The purchasing power of adjusted NIS reflects the average price level in December 2003, according to the Israeli Consumer Price Index ("CPI") published on January 15, 2004 (178.6 points on the average basis of 1993 = 100). (See Note c, below)
2. The adjusted amounts of non-monetary assets do not necessarily represent realizable value or current economic value, but only the original historical cost of those assets in terms of adjusted NIS.
3. The term "cost" in these consolidated financial statements signifies cost in adjusted NIS.

c. Principles of adjustments:

1. Balance sheet:

- a) Non-monetary items (items whose amounts in the balance sheet reflect their nominal amounts upon acquisition or

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incurrence, see below) have been adjusted on the basis of the changes in the Israeli CPI since their acquisition or incurrence.

Items which were treated as non-monetary include: inventories, prepaid expenses, property and equipment and the related accumulated depreciation, share capital and additional paid-in capital derived from cash received from shareholders.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- b) Minority interest in a subsidiary and the related operating results for the reported year, are included on the basis of the adjusted financial statements of that company.
- c) Monetary items (items whose amounts in the balance sheet reflect current or realizable values) are presented in the balance sheet as of December 31, 2003 in their nominal amounts (comparative figures have been adjusted to the December 2003 Israeli CPI).

2. Statement of operations:

- a) The components of the statement of operations (except for financing), relating to transactions carried out during the year - sales, purchases, labor costs, etc., have been adjusted on a monthly basis, on the basis of the Israeli CPI at the time the related transactions were carried out or paid. The erosion of monetary balances relating to the aforesaid transactions has been included in financial income or expenses.
- b) The components of the statement of operations relating to non-monetary items included in the balance sheet, (such as changes in inventories, depreciation, capital gains and minority interest in subsidiary) have been adjusted on the same basis used for the adjustment of the related balance sheet items.
- c) The components of the statement of operations relating to provisions included in the balance sheet, such as liability in respect of accrued severance pay and accrued vacation pay, have been included according to the analysis of the adjusted change in the related balance sheet items after their relative cash flows are taken into account.
- d) Current taxes include the expense which derives from the erosion of the value of payments on account of income taxes from the date of payment to the end of the year.

As for deferred income taxes, see j. below.
- e) The financing item, net, reflects real financial income and expenses in real terms, and results of the derivative financial instruments, as well as the erosion of monetary

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balances during the year.

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3. Convenience translation into U.S. dollars:

The adjusted financial statements as of December 31, 2003 and for the year then ended, have been translated into U.S. dollars using the representative exchange rate of the U.S. dollar as of such date (U.S.\$ 1 = NIS 4.379). The translation was made solely for the convenience of the readers. It should be noted that the adjusted New Israeli Shekel figures do not necessarily represent the current costs of the various elements presented, and that the translated U.S. dollar figures should not be construed to represent amounts receivable or payable in dollars, or convertible into dollars, unless otherwise indicated in these statements.

4. Data regarding Israeli CPI and exchange rates of foreign currency:

1. Assets and liabilities in or linked to foreign currency are included in the financial statements according to the representative exchange rates as published by the Bank of Israel on December 31, 2003.
2. Assets and liabilities linked to the Israeli CPI are included in the financial statements according to the relevant index for each asset or liability.

The following are details of the Israeli CPI and the exchange rate of the U.S. dollar:

AT DECEMBER 31:	ISRAELI CPI	EXCHANGE RATE OF THE U.S. DOLLAR
-----	-----	-----
	POINTS *)	NIS
-----	-----	-----
2003	178.6	4.379
2002	182.0	4.737
2001	170.9	4.416
2000	168.5	4.041
CHANGES DURING THE YEAR:	%	%
-----	-----	-----
2003	(1.9)	(7.6)
2002	6.5	7.3
2001	1.4	9.3

*) According to the Israeli CPI for the month ending on the

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balance sheet date on an average basis of 1993 = 100.

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d. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its over 50% controlled subsidiaries and a jointly controlled entity. Intercompany balances and transactions among the Company and the subsidiaries (wholly consolidated or consolidated using the proportionate consolidation method) have been eliminated upon consolidation. As for tax aspects, see j. below.

e. Cash equivalents:

Cash equivalents are considered by the Group to be highly liquid investments, which include unrestricted short-term bank deposits originally purchased with maturities of three months or less.

f. Allowance for doubtful debts:

Such allowance is determined in respect of specific debts which, based on management's estimation, are doubtful of collection.

g. Inventories:

Inventories are stated at the lower of cost or market value. Cost of inventories is determined on the following basis:

Raw materials and goods in transit - using the "first-in, first-out" method.

Supplies and packaging materials - on the basis of moving-average cost.

Work in progress and finished products - on the basis of computed direct manufacturing costs with allocable indirect manufacturing costs.

h. Property and equipment:

1. The assets are stated at cost, net of related investment grants received from the State of Israel under the terms of the Law for the Encouragement of Capital Investments and net of accumulated depreciation. Cost of pallets and spare parts are stated as base stock.

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1. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The annual depreciation rates are as follows:

	%
Buildings	8
Machinery and equipment	6 - 10
Motor vehicles and forklifts	10 - 15
Office furniture and equipment	6 - 33
Leasehold improvements	over the term of the lease

- i. Sale - leaseback transaction:

The Company accounts for sales with leasebacks in accordance with Statement of Financial Accounting Standards ("SFAS") 28, "Accounting for Sales With Leasebacks".

The Company entered into two sale - leaseback transactions of machinery and equipment. The first transaction occurred in September 1998 for the aggregate amount of adjusted NIS 15,559 thousand and the second transaction occurred in October 2000 for the aggregate amount of adjusted NIS 17,626 thousand. The unearned gain is immaterial. The Company retains the option to purchase the machinery and equipment at the end of the lease period.

The leases are capital leases for a period of four years and five years, respectively.

During September 2002, upon the fulfillment of its liability under the first lease the Company exercised its option to purchase the machinery and equipment under the lease in consideration of adjusted NIS 64 thousand (\$ 15 thousand).

The Company depreciates the leased machinery and equipment over the remaining estimated useful lives of the machinery and equipment (approximately ten years).

- j. Deferred income taxes:

1. Deferred income taxes are computed in respect of temporary differences between the carrying amounts of the assets and liabilities included in these financial statements and those to be considered for tax purposes. As for the main components in respect of which deferred income taxes have been included, see Notes 16g and 16d.

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2. Deferred income tax balances are computed at the enacted tax rate expected to be in effect at the time when these taxes will be released to the statement of operations. The amount presented in the statement of operations represents the changes in the said balances during the reported year.
3. The Company has not recorded deferred income taxes for the realization of investments in subsidiaries that management intends to retain. Similarly, deferred income taxes have not been provided for future taxable distributions from subsidiaries, since it is the Company's policy not to initiate a distribution of dividend that involves an additional tax liability to the Group.

k. Revenue recognition:

Revenues from sales net of discounts are recognized when persuasive evidence of an agreement exists, delivery of the products has occurred, the fee is fixed or determinable, collectibility is probable and no significant obligations remain.

l. Earnings per share:

Earnings per share are computed based on the weighted average number of Ordinary shares outstanding during the year, in accordance with Opinion 55 of the Institute of Certified Public Accountants in Israel.

All outstanding stock options have been excluded from the calculation of the net loss per share, because all the outstanding stock options are anti-dilutive for all periods presented. As of December 31, 2003, all the options have been expired.

m. Derivative financial instruments:

The Company neither holds nor issues financial instruments for trading or speculative purposes.

The Company enters into call option contracts to hedge certain of its balance sheet exposure against changes in foreign currency exchange rates. Such exposure is a result of the portion of the Company's liabilities being denominated in currencies other than NIS.

Gains and losses on the options are included in the statement of operations in financial expenses, net, along with the exchange rate changes of the underlying foreign currency denominated liabilities. During the year ended December 31, 2003, the Company recognized a net loss of adjusted NIS 138 thousand (\$ 32 thousand). Total notional amount of the open contracts is \$ 1,150,000 as of December 31, 2003.

All of the call option contracts are due until March 9, 2004.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

n. Advertising expenses:

Advertising expenses are carried to the statement of operations as incurred. Advertising expenses for the years ended December 31, 2001, 2002 and 2003, were approximately adjusted NIS 262 thousand, adjusted NIS 243 thousand, and adjusted NIS 146 thousand (\$ 33 thousand), respectively.

o. Severance pay:

The Group's liability for severance pay, which reflects the undiscounted amount of liability, is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Group's liability for all of its employees, is fully provided by monthly deposits with insurance policies and by an accrual.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expenses for the years ended December 31, 2001, 2002 and 2003, amounted to approximately adjusted NIS 2,244 thousand, adjusted NIS 3,298 thousand and adjusted NIS 2,710 thousand (\$ 619 thousand), respectively.

p. Fair value of financial instruments:

The following disclosures of the estimated fair value of financial instruments have been determined by the Group using available market information and valuation methodologies described below. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein may not be indicative of the amounts that the company could realize in a current market exchange. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

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The carrying values of cash and cash equivalents, trade

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receivables, short-term credit from banks and others and trade payables approximate their fair values due to the short-term maturities of these instruments.

The carrying amount of the Group's long-term borrowing arrangements, capital lease obligations and liability to investment center approximates their fair value. The fair value of the Group's long-term borrowings and capital lease obligations is estimated using discounted cash flows analysis, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

q. Accounting for stock based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25") and Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized.

As of December 31, 2002, all options have been expired.

r. Concentration of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables.

The Group's cash and cash equivalents are invested in deposits in major Israeli banks. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

Concentrations of credit risk with respect to trade receivables are limited due to the large number of entities comprising the Group's customer base and their dispersion across many different industries. The Group performs ongoing credit evaluations of its debtors. In management's estimations, the allowance for doubtful debts adequately covers anticipated losses in respect of its accounts receivable credits risks.

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s. Reclassification:

Certain amounts from prior years have been reclassified to conform with current period presentation.

t. Effects of new accounting standards on the financial

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statements:

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements, and Accounting Standard No. 13 with respect to the effect of changes in foreign exchange rates. In December 2002, Accounting Standard No. 17 was published with respect to the deferral of the effective date of Accounting Standards No. 12 and No. 13 to January 1, 2004.

According to Accounting Standards No. 12 and No. 17, which deal with the discontinuance of the adjustment of financial statements, financial statements will cease to be adjusted for inflation in Israel beginning January 1, 2004. Until December 31, 2003, the Company continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements as of December 31, 2003, will serve as the starting point for nominal financial reporting beginning January 1, 2004.

Accounting Standard No. 13 prescribes principles with respect to the effect of changes in foreign exchange rates. This Standard replaces Interpretations No. 8 and No. 9 of Opinion No. 36 of the Institute of Certified Public Accountants in Israel, which have been superseded upon the discontinuance of the adjustment of financial statements. The Standard deals with the translation of foreign currency transactions and with the translation of financial statements of foreign operations for incorporation into the financial statements of the reporting enterprise. The translation principles of Accounting Standard No. 13 are different from those applied to date.

The effect of the adoption of Accounting Standard No. 12 is dependent on the inflation rate in Israel, on the composition of the Company's assets and its sources of financing at that time.

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The Company believes that the effect of Standard No. 13 on its results of operations, financial position and cash flows is not expected to be material.

- u. Pro forma information regarding net income and net earnings per share is required by SFAS-123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. Such information does not have any effect for the years 2001, 2002 and 2003.

NOTE 3: - TRADE RECEIVABLES

- a. Composition:

	DECEMBER 31,	
	2002	2001
	ADJUSTED NIS	
	(IN THOUSANDS)	
Open accounts	104,250	121,537
Notes receivable	17,287	14,287
	-----	-----
	121,537	136,069
Less - allowance for doubtful debts	2,468	2,468
	-----	-----
	119,069	133,601
	=====	=====

b. As for balances with related parties, see Note 18b.

c. The following are the changes in the allowance for doubtful accounts for each of the three years in the period ended December 31, 2003 (Adjusted NIS in thousand).

	BALANCE AT OPENING OF PERIOD	CHARGES TO THE PROFIT AND LOSS	WRITE-OFF OF PREVIOUSLY PROVIDED ACCOUNTS	BALANCE AT PERIOD ENDING
YEAR ENDED DECEMBER 31, 2003	2,468	230	(457)	2,241
YEAR ENDED DECEMBER 31, 2002	3,668	254	(1,454)	2,468
YEAR ENDED DECEMBER 31, 2001	5,595	392	(2,319)	3,668

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CARMEL CONTAINER SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4: - OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

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	DECEMBER 31,	
	2002	2003
	ADJUSTED NIS	
	(IN THOUSANDS)	
Related parties (1)	971	382
Employees	146	142
Government authorities	394	470
Deferred income taxes (2)	589	629
Prepaid expenses	1,605	1,609
Other receivables	399	426
	-----	-----
	4,104	3,658
	=====	=====

(1) See Note 18b.

(2) See Note 16e.

NOTE 5: - INVENTORIES

Raw materials	31,605	20,481
Supplies and packaging materials	2,107	2,085
Work in progress	1,430	1,245
Finished products	10,861	11,319
	-----	-----
Goods in transit	46,003	35,130
	2,934	6,230
	-----	-----
	48,937	41,360
	=====	=====

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NOTE 6: - PROPERTY AND EQUIPMENT, NET

a. Composition:

LAND AND BUILDINGS	MACHINERY AND EQUIPMENT **)	MOTOR VEHICLES AND FORKLIFTS	OFFICE FURNITURE AND EQUIPMENT
-----	-----	-----	-----

ADJUSTED NIS
(IN THOUSANDS)

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Cost:				
Balance as of January 1, 2003*)	13,199	345,524	11,796	19,647
Additions during the year	48	2,903	357	467
Disposals during the year	-	(1,164)	(1,717)	(231)
	-----	-----	-----	-----
Balance at December 31, 2003	13,247	347,263	10,436	19,883
	-----	-----	-----	-----
Accumulated depreciation:				
Balance as of January 1, 2003*)	10,630	239,252	8,523	16,915
Additions during the year	332	20,966	950	1,397
Disposals during the year	-	(1,039)	(1,173)	(229)
	-----	-----	-----	-----
Balance at December 31, 2003	10,962	259,179	8,300	18,083
	-----	-----	-----	-----
Depreciated cost at December 31, 2003	2,285	88,084	2,136	1,800
	=====	=====	=====	=====
Depreciated cost at December 31, 2002	2,569	106,272	3,273	2,732
	=====	=====	=====	=====

** TABLE CONTINUED **

	TOTAL	CONVENIENCE TRANSLATION TOTAL
	-----	-----
		U.S. \$
	-----	-----
Cost:		
Balance as of January 1, 2003*)	413,880	94,515
Additions during the year	4,446	1,015
Disposals during the year	(3,516)	(803)
	-----	-----
Balance at December 31, 2003	414,810	94,727
	-----	-----
Accumulated depreciation:		
Balance as of January 1, 2003*)	285,820	65,271
Additions during the year	23,781	5,431
Disposals during the year	(2,441)	(558)
	-----	-----
Balance at December 31, 2003	307,160	70,144
	-----	-----
Depreciated cost at December 31, 2003	107,650	24,583
	=====	=====
Depreciated cost at December 31, 2002	128,060	29,244

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=====

** TABLE COMPLETE **

- *) Reclassified.
 - **) Net of investment grant (see Note 2h) amounting to adjusted NIS 947 thousand and adjusted NIS 659 thousand (\$ 150 thousand) for the years ended December 31, 2002 and 2003, respectively.
 - **) Including machinery and equipment under capital lease - cost amounting to adjusted NIS 31,985 thousand (\$ 7,304 thousand) and accumulated depreciation amounting to adjusted NIS 13,402 thousand (\$ 3,061 thousand) as of December 31, 2003. See Notes 7 and 11.
- b. As for charges, see Note 14. As for claims, see Note 13b.
 - c. Depreciation expenses amounted to adjusted NIS 26,786 thousand, adjusted NIS 25,567 thousand and adjusted NIS 23,781 thousand (\$ 5,431 thousand) for the years ended December 31, 2001, 2002 and 2003, respectively.

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NOTE 7: - LEASES

- a. The facilities that include offices and warehouses of the Group are rented under operating leases for various periods ending in 2016.
- b. Future minimum rental commitments under the aforementioned non-cancelable leases (all of which are operating leases) are linked either to the exchange rate of the U.S. dollar or to the Israeli CPI in effect as of balance sheet date, as follows:

	ADJUSTED NIS	CONVENIENCE TRANSLATION U.S. \$
	-----	-----
	(IN THOUSANDS)	
For the years ending December 31,		
2004	12,805	2,924
2005	11,800	2,695
2006	11,245	2,568
2007 and thereafter	88,165	20,134
	-----	-----
	124,015	28,321
	=====	=====

Rent expenses amounted to approximately adjusted NIS 13,053 thousand, adjusted NIS 13,151 thousand and adjusted NIS 12,875 thousand (\$ 2,940 thousand) for the years ended December 31, 2001, 2002 and 2003, respectively.

NOTE 8: - SHORT-TERM CREDIT FROM BANKS AND OTHERS

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a. Composition:

	AVERAGE INTEREST RATE		UNLINKED DECEMBER 31,	
	2002	2003	2002	2003
	%		ADJUSTED NIS	
			(IN THOUSANDS)	
Overdrafts	11.0	10.6	464	273
Short-term credit from banks	10.2	8.9	6,796	21,000
Short-term credit from others	18.2	16.2	2,944	3,000
			10,204	24,273

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- b. As of December 31, 2003, the Group had authorized credit lines from several banks in the amount of adjusted NIS 3,725 thousand (\$ 851 thousand), which bear interest at the average rate of Prime +1.8%.

The Group had an unused credit facility in the amount of approximately adjusted NIS 3,452 thousand (\$ 788 thousand) as of December 31, 2003 (there is no fee for the unused portion of the credit facility).

The weighted average interest rate of short-term credit in unlinked NIS as of December 31, 2002 and 2003, was approximately 12.5% and 8.6%, respectively.

- c. As for charges to collateralize part of the short-term loans and credit, see Note 14.

NOTE 9: - TRADE PAYABLES

	DECEMBER 31,	
	2002	2003
	ADJUSTED NIS	
	(IN THOUSANDS)	
Trade payables	67,564	61,897
Notes payable	7,014	1,560

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	74,578	63,457
	=====	=====
Including shareholders (1)	21,260	20,712
	=====	=====
Including investee of a shareholder (1)	18,354	5,664
	=====	=====

(1) See Note 18a.

NOTE 10: - OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Related companies of a shareholder (1)	1,313	1,253
Liabilities to employees and payroll accruals	10,421	10,710
Government authorities	1,611	3,338
Accrued expenses (2)	1,769	1,068
Other	408	171
	-----	-----
	15,522	16,540
	=====	=====

(1) See Note 18a.

(2) See Note 16e.

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NOTE 11: - LONG-TERM LOANS FROM BANKS AND OTHERS AND CAPITAL LEASE OBLIGATIONS

a. Composition of long-term loans from banks and others.

1. Banks:

	DECEMBER 31, 2002	2003 ADJUSTED NIS
	-----	-----
	(IN THOUSANDS)	
Banks	55,991	46,991
Less - current maturities	27,407	18,712
	-----	-----
	28,584	28,279
	=====	=====

2. Capital lease obligations:

Capital lease obligations	10,682	7,584
Less - current maturities	3,240	3,619
	-----	-----

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	7,442	3,965
	=====	=====
3. Liability in respect of an investment grant refund (Note 16a(1))		
	1,572	982
Less - current maturities (included in other accounts payable)	608	620
	-----	-----
	964	362
	=====	=====

As to pledges to secure these liabilities, see Note 14.

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b. The loans are classified by linkage terms and interest rates as follows:

1. Banks:

	AVERAGE INTEREST RATE		DECEMBER 31,		CONVENIEN
	2002	2003	2002	2003	TRANSLATI
	-----		-----		DECEMBER
	-----		-----		2003
	-----		-----		-----
Unlinked Israeli	%		ADJUSTED NIS		U.S. \$
	-----		-----		-----
CPI In or linked					(IN THOUS
U.S. \$					
	8.5	8.5	47,099	45,495	10,389
	4.7	4.7	6,103	1,496	342
	3.1	2.4	2,789	-	-
			-----	-----	-----
			55,991	46,991	10,731
			=====	=====	=====

2. Capital lease obligations:

	AVERAGE INTEREST RATE		DECEMBER 31,		CONVENIEN
	2002	2003	2002	2003	TRANSLATI
	-----		-----		DECEMBER
	-----		-----		2003
	-----		-----		-----
Unlinked	%		ADJUSTED NIS		U.S. \$
	-----		-----		-----
					(IN THOUSANDS)
	9.3	9.3	10,682	7,584	1,732

c. Repayment dates subsequent to the balance sheet date are as follows:

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1. Banks:

	DECEMBER 31, ----- 2003 ----- ADJUSTED NIS -----	CONVENIENCE TRANSLATION DECEMBER 31, ----- 2003 ----- U.S. \$ -----
	(IN THOUSANDS)	
First year (current maturities)	18,712	4,27
	-----	-----
Second year	9,993	2,28
Third year	10,294	2,35
Fourth year	5,447	1,24
Fifth year	2,545	58
	-----	-----
	28,279	6,45
	-----	-----
	46,991	10,73
	=====	=====

2. Capital lease obligations:

First year (current maturities)	3,619	82
	-----	-----
Second year	3,965	90
	-----	-----
	7,584	1,73
	=====	=====

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3. Liability in respect of an investment grant refund:

	DECEMBER 31, ----- 2003 ----- ADJUSTED NIS -----	CONVENIENCE TRANSLATION DECEMBER 31, ----- 2003 ----- U.S. \$ -----
	(IN THOUSANDS)	
First year (current maturities)	620	141
	-----	-----
Second year	362	83
	-----	-----
	982	224

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NOTE 12: - ACCRUED SEVERANCE PAY, NET

a. Severance pay and retirement grants:

Under Israeli law and valid labor agreements, the companies of the Group are required to make severance or current pension payments in addition to retirement grants to dismissed employees and to employees leaving employment under certain other circumstances.

These liabilities are fully covered by regular deposits with severance pay, pension funds and by the balance sheet accrual.

Employees dismissed before attaining retirement age are entitled to severance pay computed on the basis of their most recent salary. As for part of the Group's employees - in the event that the amounts accumulated in the pension fund are insufficient to cover the severance pay computed as above - the Company and its subsidiaries are to supplement the difference.

The companies' employees are participants in a pension fund to which the companies make current monthly payments. The deposits relieve the companies of their severance pay liability. The pension fund is external and independent of the Group.

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Amounts deposited in severance pay funds, and related liabilities are not reflected in the balance sheet since the funds are not under the control of the Group.

b. The amounts funded for compensation are deposited with the Central Fund for Compensation and with provident funds in the name of the employees. The amounts funded may be withdrawn provided that the provisions of the severance pay law are fulfilled.

c. Below are the amounts for accrued severance pay, retirement grants and compensation for unutilized sick leave, as presented in the balance sheet:

	DECEMBER 31,		CONVENIENCE TRANSLATION DECEMBER 31
	2002	2003	2003
	ADJUSTED NIS		U.S. \$
	(IN THOUSANDS)		
Severance pay	8,655	8,702	1,987
Less - amounts funded	8,344	8,683	1,982

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	311	19	5
Compensation for unutilized sick leave	159	172	39
<hr style="border-top: 1px dashed black;"/>			
	470	191	44
<hr style="border-top: 1px dashed black;"/>			

NOTE 13: - CONTINGENT LIABILITIES AND COMMITMENTS

- a. An investee of a shareholder, which is also a supplier of raw materials, has a right of first refusal regarding the sale of part of the purchases of the Group's raw materials for a period of ten years commencing October 1998. The Group purchases raw materials from the investee of a shareholder in the ordinary course of business (see Note 18c. with respect to purchases from shareholders).

- b. Option to purchase property:

A subsidiary of the Company, Tri-Wall, containers Ltd. ("Tri-Wall") leases property in Netanya on which Tri-Wall's plant is situated, from a primary lessee ("P.L."). In accordance with the agreement, Tri-Wall has an option to purchase the property in consideration of approximately \$ 2.2 million from the P.L., who has an option to purchase the property from the owner.

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Tri-Wall gave notice to the P.L. of its intention to exercise the option. The owner of the property claims that the P.L. breached certain provisions of their agreement and therefore has no rights in the property. The matter was transferred to an arbitrator who determined that Tri-Wall has the right to exercise the option to purchase the land from the owner or that Tri-Wall should be compensated in the amount of \$ 2.9 million. In April 2003, the arbitrator's decision was approved by the District Court.

In August 2003, Tri-Wall claimed the amount of NIS 20 million (including VAT) from the P.L. The P.L. has refused to pay this amount and is continuing its efforts to nullify all decisions against it. The execution office is continuing enforcement procedures against the P.L.

In separate actions filed by the owner and the P.L., on January 16, 2000, the district court ruled that the P.L. is not entitled to exercise the option as a result of a breach of the lease contract. Notwithstanding the above, the ruling determined that Tri-Wall is entitled to exercise the option and acquire the property. The consideration is to be paid directly to the owner of the property. The Court did not specify the exercise price of the option or the date the option can be exercised. The owner and the P.L. have appealed to the Supreme Court, which has been holding hearings on this matter.

The Company has transferred the monthly rent payments for the period commencing March 2000 to a designated bank deposit. The rent expenses have been recorded in the financial statements.

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- c. As for guarantees among the companies of the Group, see Note 14c.
- d. As for leases, see Notes 7 and 11.

NOTE 14: - CHARGES (ASSETS PLEDGED) AND GUARANTEES

- a. As collateral for the Group's liabilities to banks, the State of Israel and a shareholder, a fixed charge was placed, in an unlimited amount, on any unpaid share capital, equipment, machinery, insurance rights and the shares of Tri-Wall, and a floating charge was placed on all the other properties of the Group's plants and the assets.
- b. As collateral for repayment of a loan for the lease of property and equipment in the context of sale - leaseback transaction of machinery and equipment, the Company provided bank guarantee totaling adjusted NIS 10,188 thousand (\$ 2,151 thousand). The Company has also mortgaged, in favor of the lender, a containers production line.

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- c. The Company has provided a guarantee to the State of Israel in favor of a subsidiary (C.D. Packaging Ltd.) in connection with investment grants received by C.D. in an amount not to exceed 50% of C.D. liabilities in respect of its "approved enterprise". As of December 31, 2003, a guarantee of an amount not to exceed adjusted NIS 491 thousand (\$ 112 thousand) was provided, see Note 16a(1).
- d. Liabilities secured by pledges are as follows:

	DECEMBER 31,		CONVENIENCE TRANSLATION DECEMBER 31,
	2002	2003	2003
	ADJUSTED NIS (IN THOUSANDS)		U.S. \$
Short-term loans and credit	7,260	21,273	4,858
Long-term liabilities including current maturities	67,460	50,972	11,640
	-----	-----	-----
	74,720	72,245	16,498
	=====	=====	=====

NOTE 15: - SHARE CAPITAL

- a. The shares of the Company are traded on the American Stock Exchange in the United States.

DECEMBER 31, 2002 AND 2003

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	AUTHORIZED	ISSUED AND OUTSTANDING *
	NUMBER OF SHARES	
Ordinary shares of NIS 1 par value each	10,000,000	2,520,000

*) As of December 31, 2003, a subsidiary of the Company holds a total of 119,813 of the Ordinary shares of NIS 1 par value of the Company, which is netted from shareholders' equity in the amount of adjusted NIS 4,258 thousand. The shares are presented in the financial statements under the cost method.

The Ordinary shares confer upon their holders the right to participate and vote in the general meetings, the right to receive dividends and the right to a share in excess of assets upon liquidation of the Company.

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b. Share option plan:

In August 1996, the Company's Board of Directors has authorized through share option plan ("the plan") the grant of options to the Company's employees of up to 100,000 of the Company's Ordinary shares at the exercise price of \$ 8.5 per share (the share's market price at the date the plan was approved, was \$ 10). Half of the options are exercisable after two years and the other half are exercisable after three years. The options are expired within 7 years. Any options that are canceled or forfeited before expiration become available for future grant.

As of December 31, 2002, all options have been expired.

A summary of the Company's share option activity and related information, is as follows:

	YEAR ENDED DECEMBER 31,			
	2001		2002	
	AMOUNT OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	AMOUNT OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
		\$		\$
Outstanding - at beginning of year	54,000	8.5	54,000	8.5
Outstanding - at end of year	54,000	8.5	-	-

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Exercisable options	54,000	8.5	-	-
---------------------	--------	-----	---	---

As of December 31, 2003, no options are available for future grant.

c. Dividends:

Dividends declared on the Ordinary shares will be paid in NIS. Dividends paid to shareholders outside Israel will be converted into dollars, on the basis of the exchange rate prevailing at the date of payment.

NOTE 16: - INCOME TAXES

a. Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959:

1. The Company's subsidiary, C.D. Packaging Systems Ltd. ("C.D.") was granted the status of an "approved enterprise", including an expansion plan, pursuant to the law for the Encouragement of Capital Investments 1959, as amended.

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On December 8, 2002, the Investment Center management informed C.D. on the cancellation of the approval from 1992, retroactively since C.D. failed to comply with the terms contained in the approval.

In addition, C.D. was compelled to fulfill the following conditions:

- a) To refund certain investment grants that C.D. received in the amount of NIS 1,860 thousand, which will be paid in 36 equal monthly installments starting August 2002. The refund amount was charged to property and equipment from which it was previously netted.
 - b) C.D. committed to employ the amount of employees, as determined by the Investment Center management, through 2005.
 - c) The Company and C.D.'s other shareholders guarantee C.D.'s liabilities as stated in the above items 1) and 2).
2. In 1997, the production facilities of the Company's subsidiary Tri-wall containers Ltd. ("Tri-wall") have been granted the status of an "approved enterprise" under the Law of the Encouragement of Capital Investments, 1959. Tri-wall has elected the alternative benefits, waiving grants in return for tax exemption. In accordance with this Law, the income from the approved enterprise will be exempt from tax for a period of two years and for the remaining benefit period will be subject to a reduced tax rate of 25%. The total benefit period is for ten years, commencing with the first year in which taxable income is generated, but limited to twelve years from commencement of production or fourteen

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years from the date of approval, whichever is earlier ("benefit period").

The entitlement to the above benefits is conditional upon Tri-Wall's fulfilling the conditions stipulated by the above 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 canceled and Tri-Wall may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2003, management believes that Tri-Wall is meeting all of the aforementioned conditions.

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During 2003, Tri-Wall received final approval of implementation of the investment program.

Due to tax losses incurred by the Company, tax benefit period for the approved enterprise program has not yet commenced. In accordance with the law the total benefit period will expire in 2009.

The tax exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without imposing tax liability on the company only upon the complete liquidation of the Company.

The subsidiary has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's subsidiaries' "Approved Enterprise". If the retained tax-exempt income is distributed in a manner other than in the complete liquidation of the subsidiaries, it would be taxed at the corporate tax rate applicable to such profits as if the Company has not elected the alternative tax benefits. As of December 31, 2003, the subsidiaries have immaterial tax-exempt profits from the "Approved Enterprise".

Income derived from sources other than approved enterprises are taxed at the regular tax rate of 36%.

- b. Tax benefits under the Law for the Encouragement of Industry ("Taxation"), 1969:

The Company and its subsidiaries are "industrial companies" under the Law for the Encouragement of Industry (Taxation), 1969, and as such are entitled to certain tax benefits by virtue of this law, mainly accelerated depreciation.

Under the above law, the Company and Tri-Wall, file consolidated tax returns.

- c. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

The provisions of the Income Tax (Inflationary Adjustments) Law, 1985 apply to the Company and certain of its Israeli investees. According to the law, the results for tax purposes are measured

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based on the changes in the Israeli CPI. In November 2001, an amendment to the Income Tax (Inflationary Adjustments) Law (Amendment No. 14), 2001 was passed by the "Knesset" (Israeli

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parliament), pursuant to which until February 28 of the year following the reported tax year, the Minister of Finance, with the approval of the finance committee of the Knesset, is entitled to determine by an order that the provisions of the aforesaid law, in whole or in part, will not apply with respect to a certain tax year if the Israeli CPI in that year did not increase by more than 3%. In February 2004, the Minister of Finance and the finance committee decided that the Inflationary Adjustments Law will be implemented with respect to 2003.

The tax liability for 2003 is computed according to the law, while taking into account the decrease in the Israeli CPI in that year.

d. Deferred income taxes:

1. Deferred income taxes are computed in respect of temporary differences between the carrying amounts of assets and liabilities included in these financial statements and those to be considered for tax purposes.

The main components in respect of which deferred income taxes have been included are as follows:

Depreciation in respect of property and equipment in the adjusted financial statements and for tax purposes (taking into consideration Opinion No. 40 of the Institute of Certified Public Accountants in Israel); differences between the value of inventories in the adjusted financial statements and its value for tax purposes; differences in accounting for other income and expenses items in the adjusted financial statements and for tax purposes (mainly provisions for employee rights); carryforward losses.

2. Significant components of the Company and its subsidiaries deferred tax liabilities and assets are as follows:

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	DECEMBER 31,	
	2002	2001
	ADJUSTED NIS	
	(IN THOUSANDS)	
Deferred tax assets:		
Tax loss carryforward	26,313	23,200

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Provision for employee rights	2,105	1,8
Allowance for doubtful debts	854	8
Others	373	3
	-----	-----
Net deferred tax assets before valuation allowance	29,645	26,3
Valuation allowance	(240)	
	-----	-----
Net deferred tax assets	29,405	26,3
	-----	-----
Deferred tax liabilities:		
Depreciable property and equipment	36,124	30,9
Inventories	505	
	-----	-----
Net deferred tax liability	36,629	30,9
	-----	-----
Net deferred tax liabilities (domestic)	7,224	4,6
	=====	=====

- e. Deferred income taxes are presented in the balance sheet as follows:

	DECEMBER 31,	
	2002	2001
	ADJUSTED NIS	
	(IN THOUSANDS)	
Among current assets ("Other accounts receivable and prepaid expenses")	589	6
Among long-term liabilities	(7,813)	(5,2)
	-----	-----
	(7,224)	(4,6)
	=====	=====

- f. Income tax reconciliation:

A reconciliation between the theoretical tax expense assuming all income is taxed at the statutory rate of 36% and the actual tax expense is as follows:

	YEAR ENDED DECEMBER 31	
	2001	2002
		ADJUSTED NIS
		(IN THOUSANDS)
Loss before taxes on income	(14,538)	(15,285)
	=====	=====
Theoretical tax expense (benefit) computed at the Israeli statutory tax rate - 36%	(5,233)	(5,502)
Increase (decrease) in income taxes resulting from:		
Tax adjustments in respect of inflation in Israel and others	(342)	(424)
Non-deductible expenses (tax exempt income) and others, net	30	(180)
Increase (decrease) in tax expense due to reduced tax rates in companies which were granted approved enterprise status	(9)	180
Utilization of losses and capital losses which were not recorded as an asset in the and in previous years	(13)	-
	-----	-----
Actual tax benefit	(5,567)	(5,926)
	=====	=====
g. Income taxes included in the statements of operations (domestic):		
Deferred income taxes, net	(5,567)	(6,257)
Taxes in respect of previous years	-	331
	-----	-----
	(5,567)	(5,926)
	=====	=====

h. Income tax assessments:

Final tax assessments have been received by the Company and its subsidiaries as follows:

Carmel Systems and Tri-Wall Containers up to and including the 2000 tax year, C.D. Packaging Systems up to and including the 1999 tax year. Solid Packaging Board has not yet been assessed since incorporation.

DECEMBER 31, 2003

	LINKED TO THE ISRAELI CONSUMER PRICE INDEX	IN OR LINKED TO FOREIGN CURRENCY	UN
Assets:			
Cash and cash equivalents	-	83	
Trade receivables	-	1,802	
Other accounts receivable and prepaid expenses	394	-	
	394	1,885	
Liabilities:			
Short-term credit from banks and others	-	-	
Trade payables	-	53,202	
Other accounts payable and accrued expenses	-	1,313	
Long-term loans from banks and others (including current maturities)	6,103	2,789	
Capital lease obligation (including current maturities)	-	-	
	6,103	57,304	

** TABLE CONTINUED **

DECEMBER 31, 2003

	LINKED TO THE ISRAELI CONSUMER PRICE INDEX	IN OR LINKED TO FOREIGN CURRENCY	UN
Assets:			
Cash and cash equivalents	-	3	
Trade receivables	-	2,131	
Other accounts receivable and prepaid expenses	261	-	
	261	2,134	
Liabilities:			
Short-term credit from banks and others	-	-	

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Trade payables	-	40,778
Other accounts payable and accrued expenses	-	1,253
Long-term loans from banks and others (including current maturities)	1,496	-
Capital lease obligation (including current maturities)	-	-
	-----	-----
	1,496	42,031
	=====	=====

** TABLE COMPLETE **

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NOTE 17:- LINKAGE TERMS OF MONETARY BALANCES (CONT.)

	LINKED TO THE ISRAELI CONSUMER PRICE INDEX	IN OR LINKED TO FOREIGN CURRENCY
	-----	-----
		CONVENIENCE
		(IN
Assets:		
Cash and cash equivalents	-	1
Trade receivables	-	487
Other accounts receivable and prepaid expenses	60	-
	-----	-----
	60	488
	=====	=====
Liabilities:		
Short-term credit from banks and others	-	-
Trade payables	-	9,312
Other accounts payable and accrued expenses	-	286
Long-term loans from banks and others (including current maturities)	342	-
Capital lease obligation (including current maturities)	-	-
	-----	-----
	342	9,598
	=====	=====

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18: - TRANSACTIONS AND BALANCES WITH RELATED PARTIES

a. Current liabilities to related parties:

	LINKAGE ----- TERMS -----	INTEREST ----- RATE -----	DECEMBER 31, ----- 2002 ----- ADJUSTED NIS -----
1. Trade payables:			
Shareholder	U.S. \$	Interest free	21,260
Related companies of a shareholder	U.S. \$	Interest free	18,354
2. Other accounts payable and accrued expenses:			
Related companies of a shareholder	U.S. \$	Interest free	1,313

b. Current receivables from related parties:

1. Trade receivables:			
Related parties	Unlinked Euro	Interest free	1,011 1,236
2. Other accounts receivable and prepaid expenses:			
Investees of shareholders	Unlinked	Interest free	723

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NOTE 18:- TRANSACTIONS AND BALANCES WITH RELATED PARTIES (CONT.)

c. Transactions with related parties:

The Company sells to, shareholders, investees of a shareholder and purchases raw materials from investees of a shareholder and shareholders. The terms of these transactions do not differ materially from similar transactions with third parties. The sales, purchases and other transactions are as follows:

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	INVESTEES OF A SHAREHOLDER	SHAREHOLDERS ADJUSTED NIS	TOTAL
	-----	-----	-----
			(IN THOUSANDS)
In 2003:			
Expenses:			
Purchases of raw materials	18,986	71,721	90,
Financing and commissions	(45)	(1,575)	(1,
	-----	-----	-----
	18,941	70,146	89,
	=====	=====	=====
Sales	9,418	4,265	13,
	=====	=====	=====

	INVESTEES OF A SHAREHOLDER	SHAREHOLDERS ADJUSTED NIS	TOTAL
	-----	-----	-----
			(IN THOUSANDS)
In 2002:			
Expenses:			
Purchases of raw materials		30,720	74,44
Financing and commissions		-	29
		-----	-----
		30,720	74,74
		=====	=====
Sales		9,291	3,83
		=====	=====
In 2001:			
Expenses:			
Purchases of raw materials		32,468	61,82
Financing and commissions		-	67
		32,468	62,50
		=====	=====
Sales		12,044	8,51
		=====	=====

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NOTE 19: - SUPPLEMENTARY INFORMATION TO THE STATEMENTS OF OPERATIONS

a. Cost of revenues:

YEAR ENDED DECEMBER 31,

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	2001	2002	2003
	ADJUSTED NIS		
	(IN THOUSANDS)		
Raw Materials (1)	197,335	193,871	200,000
Salaries, wages and employee benefits	53,765	52,428	50,000
Subcontracted work	3,009	3,103	3,000
Other manufacturing costs	36,235	36,212	36,000
Depreciation	24,246	23,364	23,000
	314,590	308,978	312,000
Decrease in inventories of work in progress	1,415	476	1,000
Decrease (increase) in inventories of finished products	323	1,784	1,000
	316,328	311,238	314,000

(1) As for purchases from major suppliers (related parties), see Note 18c.

b. Selling and marketing expenses:

	YEAR ENDED DECEMBER 31,		
	2001	2002	2003
	ADJUSTED NIS		
	(IN THOUSANDS)		
Salaries and employee benefits	6,920	5,163	5,000
Advertising expenses	262	243	250
Depreciation	342	289	300
Transportation and other	10,548	11,064	11,000
	18,072	16,759	17,550

c. General and administrative expenses:

Salaries and employee benefits	9,785	9,493	9,500
Depreciation	2,198	1,914	2,000
Office maintenance and other expenses (1)	7,476	6,281	6,500
	19,459	17,688	18,000
(1) Including doubtful and bad debts expenses	392	254	300

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NOTE 19:- SUPPLEMENTARY INFORMATION TO THE STATEMENTS OF OPERATIONS (CONT.)

d. Financial expenses, net:

	YEAR ENDED DECEMBER 31,	
	2001	2002
	ADJUSTED NIS	
	(IN THOUSANDS)	
Financial expenses:		
Interest expenses and bank charges:		
On short-term credit	6,205	3,014
On long-term loans	5,972	6,610
Losses arising from inflationary erosion of the Israeli currency and others	1,748	7,323
	13,925	16,947
Financial income:		
Interest income	(599)	(668)
Gains arising from inflationary erosion of the Israeli currency and others	(2,464)	(10,201)
	(3,063)	(10,869)
	10,862	6,078
e. Other income (expenses), net:		
Capital gain (loss) on sale of property and equipment, net	152	156
Other income (expenses)	-	(1,311)
	152	(1,155)

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NOTE 20: - OPERATING SEGMENTS DATA

The Company operates in three operating segments, the manufacturing of shipping containers, corrugated cardboard panels and other types of paper consumer packaging, (see Note 1a. for a brief description of the Company's

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business) and follows the requirements of Accounting Standard No. 11 Segment Reporting:

	YEAR ENDED DECEMBER 31, 200		
	SHIPPING CONTAINERS	CONSUMER PACKAGING PRODUCTS	TRI-WALL PACKAGING WOODEN PALLETS AND BOXES
	ADJUSTED NIS		
	(IN THOUSANDS)		
Revenues:			
Sales to external customers	253,561	30,148	66,322
Intersegment sales	13,645	3,856	2,719
Total revenues	267,206	34,004	69,041
Segments operating income (loss)	(8,753)	(380)	5,305
Financial expenses, net	(10,524)	(283)	(55)
Other income, net			
Tax benefit			
Minority interest in losses of a subsidiary			
Net loss			
Assets and liabilities:			
Segments assets	255,413	29,170	31,031
Total assets			
Segments liabilities	155,138	4,650	8,404
Total liabilities			
Capital investments	9,262	451	873
Depreciation	23,371	1,618	1,797

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NOTE 20: OPERATING SEGMENTS DATA (CONT.)

	YEAR ENDED DECEMBER 31, 200		
	SHIPPING CONTAINERS	CONSUMER PACKAGING PRODUCTS	TRI-WALL PACKAGING WOODEN PALLETS AND BOXES
			ADJUSTED NIS
			(IN THOUSANDS)
Revenues:			
Sales to external customers	251,090	30,091	56,452
Intersegment sales	9,579	1,410	3,284
	-----	-----	-----
Total revenues	260,669	31,501	59,736
	=====	=====	=====
Segments operating income (loss)	(11,897)	(1,631)	5,476
	=====	=====	=====
Financial expenses, net	(4,459)	(676)	(943)
	=====	=====	=====
Other expenses, net			
Tax benefit			
Minority interest in losses of a subsidiary			
Net loss			
Assets and liabilities:			
Segments assets	242,690	30,186	27,930
	=====	=====	=====
Total assets			
Segments liabilities	169,558	10,130	7,664
	=====	=====	=====
Total liabilities			
Capital investments	1,937	46	402

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	=====	=====	=====
Depreciation	21,860	1,941	1,766
	=====	=====	=====

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NOTE 20: OPERATING SEGMENTS DATA (CONT.)

	YEAR ENDED DECEMBER 31, 200		
	SHIPPING CONTAINERS	CONSUMER PACKAGING PRODUCTS	TRI-WALL PACKAGING WOODEN PALLETS AND BOXES
	-----	-----	-----
			ADJUSTED NIS

			(IN THOUSANDS)
Revenues:			
Sales to external customers	267,775	32,014	50,179
Intersegment sales	8,946	1,739	2,652
	-----	-----	-----
Total revenues	276,721	33,753	52,831
	=====	=====	=====
Segments operating income (loss)	(1,439)	(541)	2,558
	=====	=====	=====
Financial income (expenses), net	(5,540)	(58)	439
	=====	=====	=====
Other income, net			
Tax benefit			
Minority interest in losses of subsidiary			
Net loss			
Assets and liabilities:			
Segments assets	230,888	27,926	28,532
	=====	=====	=====
Total assets			
Segments liabilities	158,717	8,578	8,440
	=====	=====	=====
Total liabilities			
Capital investments	2,918	49	1,195

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	=====	=====	=====
Depreciation	20,426	2,029	1,446
	=====	=====	=====

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NOTE 20:- OPERATING SEGMENTS DATA (CONT.)

	YEAR ENDED DECEMBER 31, 200		
	SHIPPING CONTAINERS	CONSUMER PACKAGING PRODUCTS	TRI-WALL PACKAGING WOODEN PALLETS AND BOXES
	CONVENIENCE TRANSLATION INTO U.S.		
	(IN THOUSANDS)		
Revenues:			
Sales to external customers	61,150	7,311	11,459
Intersegment sales	2,043	397	606
	-----	-----	-----
Total revenues	63,193	7,708	12,065
	=====	=====	=====
Segments operating income (loss)	(329)	(124)	585
	=====	=====	=====
Financial income (expenses), net	(1,265)	(13)	100
	=====	=====	=====
Other income, net			
Tax benefit			
Minority interest in losses of a subsidiary			
Net loss			
Assets and liabilities:			
Segments assets	52,728	6,377	6,516
	=====	=====	=====
Total assets			
Segments liabilities	36,245	1,959	1,927
	=====	=====	=====
Total liabilities			

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Capital investments	666 =====	11 =====	273 =====
Depreciation	4,665 =====	463 =====	330 =====

For each of the years ended December 31, 2001, 2002 and 2003 more than 95% of the Company's revenues were derived from customers located in Israel.

All long-lived assets are located in Israel.

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CARMEL CONTAINER SYSTEMS LTD.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21: DIFFERENCES BETWEEN ISRAELI AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The consolidated financial statements of the Company conform with accounting principles generally accepted in Israel ("Israeli GAAP"), which differ in certain respects from those followed in the United States ("U.S. GAAP"), as described below:

a. Accrued severance pay, net:

According to Israeli GAAP, accrued severance pay is included in the balance sheet net of amounts funded, and income from earnings on amounts funded is netted from the severance pay expenses.

According to U.S. GAAP accrued severance pay is included in the balance sheets at the total liabilities amount and total amounts funded through provident fund and through insurance policies. Income from earnings on amounts funded is added to severance pay fund.

The effect of this difference on both income and equity is not material.

b. Effect of inflation:

The Company, in accordance with Israeli GAAP, comprehensively includes the effects of price level changes in the accompanying consolidated financial statements, as described in Note 2b. Such Israeli accounting principles measure the effects of price level changes in the inflationary nature of the Israeli economy and, as such, is considered a more meaningful presentation than financial reporting based on historical cost for Israeli and U.S. accounting purposes. As permitted by the United States Securities and Exchange Commission rules for Foreign Private Issuers whose financial statements comprehensively include the effects of inflation, price level adjustments have not been reversed and included in a reconciliation of Israeli accounting principles to

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U.S. accounting principles.

c. Treatment of deferred income taxes:

Under Israeli GAAP, deferred income taxes are not provided on the undistributed tax exempt profits of approved enterprise, where such profits have been reinvested and will not be distributed to the company shareholders.

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CARMEL CONTAINER SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21: DIFFERENCES BETWEEN ISRAELI AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT.)

Under U.S. GAAP, deferred income taxes are provided on the undistributed tax exempt profits of domestic subsidiaries that arose in fiscal years beginning after December 15, 1992.

The effect of this difference is not material.

d. Proportionate consolidation:

Under Israeli GAAP, a jointly controlled entity is included in the Company's consolidated financial statements according to the proportionate consolidation method.

Under U.S. GAAP, investments in a jointly controlled entity are accounted for by the equity method. Proportionate consolidation is permitted by the Securities and Exchange Commission regulations applicable for foreign private issuers. Disclosure required under Item 17 in form 20-F regarding the pro rata interest in the proportionately consolidated entity was not presented due to the immateriality of the aforementioned entity.

e. Base stock:

According to Israeli GAAP, pallets and spare parts are presented as base stock among property and equipment and maintained at cost, while new purchases are charged as an expense.

According to U.S. GAAP, such amounts should be capitalized and depreciated over the useful lives of the assets.

The effect of this difference on both income and equity is not material.

f. Derivative financial instruments:

Under Israeli GAAP derivative financial instruments are accounted for according to the provisions prevailing under U.S. GAAP before the adoption of Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133").

Under U.S. GAAP, SFAS No. 133, requires companies to recognize all of its derivative instruments as either assets or liabilities

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in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and

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CARMEL CONTAINER SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21: DIFFERENCES BETWEEN ISRAELI AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT.)

further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. For derivative instruments that are designated and qualify as a hedge of a net investment in a foreign currency, the gain or loss is reported in other comprehensive income as part of the cumulative translation adjustment to the extent it is effective. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

The Company uses purchased call options to hedge the fair value of balance sheet accounts denominated in foreign currencies against changes in foreign exchange rates. Due to the short-term settlement period of the derivatives instruments, the difference between the intrinsic values as required under Israeli GAAP and the fair value as required under U.S. GAAP, is immaterial.

g. Consultation fees:

The Company included in 2002 an amount of adjusted NIS 1,311 thousand in other income (expenses), which relates to consultation fee with respect to efficiency improvement of the Company's operations. Under US GAAP, these expenses should be included in the statements of operations as a part of operating

expenses.

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CARMEL CONTAINER SYSTEMS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21: DIFFERENCES BETWEEN ISRAELI AND UNITED STATES GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES (CONT.)

h. Segment information:

According to Israeli GAAP, segment disclosures are provided in accordance with the guidance of Accounting Standard No. 11 regarding segment reporting.

According to U.S. GAAP, segment disclosures are provided in accordance with the guidance of Statement of Financial Accounting Standard No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"), which defines an operating segment as a component of an enterprise that (a) engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise); (b) whose operating results are regularly reviewed by the enterprise's chief operating decision-maker to make decisions about resources to be allocated to the segment and assess its performance; and (c) for which discrete financial information is available.

For all years presented, there were no material differences between those two disclosure requirements, as both definitions resulted in the same three reportable segments.

i. Impact of recently issued accounting standards:

FASB INTERPRETATION NO. 46

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). The objective of FIN 46 is to improve financial reporting by companies involved with variable interest entities. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21: DIFFERENCES BETWEEN ISRAELI AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT.)

The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period ending after March 15, 2004. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. As of December 31, 2003, the Company does not expect the adoption of FIN 46 to have a material impact on its consolidated financial statements.

SAB NO. 104

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," ("SAB No. 104") which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

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LIST OF SUBSIDIARIES

NAME OF COMPANY	OWNERSHIP	CONTROL
	AS OF DECEMBER 31, 2003	
SUBSIDIARIES:		
C.D. Packaging Systems Ltd.	50%	50.1%
Tri-Wall Containers (Israel) Ltd.	100%	100%
Solid Packaging Board Ltd.*	100%**	100%**
INACTIVE COMPANIES:		
Plaro Container Systems (1989) Ltd.	100%	100%
Tri-Wall Pallets (1973) Ltd.	100%	100%

* Percentage of control represents the percentage of control of C.D. Packaging Systems Ltd.

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** As of December 31, 2002 - 50%.

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The following is a copy of the previously issued audit report of Arthur Andersen. This report was issued on January 28, 2002. Arthur Andersen has not reissued the report.

[Letterhead of Andersen]
[Luboshitz Kasierer]

AUDITORS' REPORT TO THE SHAREHOLDERS

OF

TRI-WALL CONTAINERS (ISRAEL) LTD.

We have audited the accompanying balance sheets of TRI WALL CONTAINERS (ISRAEL) LTD. (the Company) as of December 31, 2001 and 2000, and the related statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. 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 States and Israel, including those prescribed under the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2001 and 2000, and the results of its operations, changes in shareholders' equity and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with generally accepted accounting principles in Israel.

As described in Note 2A, the financial statements referred to above have been prepared in values adjusted for changes in the general purchasing power of the Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

/s/ Luboshitz Kasierer

Luboshitz Kasierer
Certified Public Accountants (Isr.)

Tel-Aviv. January 28, 2002

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AUDITORS' REPORT

To the shareholders of

C.D. PACKAGING SYSTEMS LTD.

We have audited the financial statements of C.D. Packaging Systems Ltd. (hereafter - the Company) and the consolidated financial statements of the Company and its proportionately consolidated subsidiary: balance sheets as of December 31, 2003 and 2002 and statements of income (loss), 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 conducted our audits in accordance with auditing standards generally accepted in the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits 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 provide 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 and consolidated - as of December 31, 2003 and 2002 and the results of operations, changes in shareholders' equity and cash flows - of the Company and consolidated - for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted ("GAAP") in Israel, which differ in certain respects from accounting principles generally accepted in the US (see note 12 to the financial statements).

As explained in note 1b, the aforementioned financial statements are presented in values adjusted to reflect the changes in the general purchasing power of Israeli currency, in accordance with pronouncements of the Institute of Certified Public Accountants in Israel.

Haifa,
March 4, 2004

SIGNATURES

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.

CARMEL CONTAINER SYSTEMS LTD.

Dated: June 27, 2004

By: /s/ Doron Kempler

Name: Doron Kempler

Title: General Manager