

TEFRON LTD

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2010

UNAUDITED

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ERNST & YOUNG
Kost Forer Gabbay & Kasierer

Review Report of the Auditors to the Shareholders of Tefron Ltd.

Preface

We have reviewed the attached financial information of Tefron Ltd. and its subsidiaries (hereinafter – the Group) which includes the condensed consolidated balance sheet as of June 30, 2010 and the condensed consolidated statements of income, comprehensive income, changes in shareholders equity and cash flows for the periods of six months and three months then ended. The Board of Directors and Management are responsible for the preparation and presentation of the financial information for these interim periods in accordance with International Accounting Standard IAS 34 – “Financial Reporting for Interim Periods”, and they are responsible and they are responsible for the preparation of financial information for these interim periods under Chapter D’ of the Securities Regulations (Periodic and Immediate Reports) – 1970. Our responsibility is to express a conclusion on the financial information for these interim periods, based on our review.

Scope of the review

We performed our review in accordance with Review Standard 1 of the Institute of Certified Public Accountants in Israel “Review of Financial Information for Interim Periods Prepared by the Entity’s Auditor”. A review of financial information for interim periods comprises clarifications, mainly with the people responsible for financial and accounting matters, and applying other analytical review procedures. A review is considerably more limited in scope than an audit carried out in accordance with generally accepted auditing standards in Israel, and therefore does not enable us to achieve with sufficient certainty that we will be aware of all significant matters which could have been identified in an audit. Consequently we are not expressing an opinion of an audit.

Conclusion

Based on our review, we are not aware of any fact which would cause us to think that the above financial information has not been prepared, in all significant aspects, in accordance with International Accounting Standard IAS 34.

In addition to the aforesaid in the previous paragraph, based on our review, we are not aware of anything which could cause us to think that the above financial information does not meet, from all significant aspects, the disclosure provisions under Chapter D of the Securities Regulations (Periodic and Immediate Reports) – 1970.

Without qualifying our above conclusions, we direct attention to Note 1c of the financial statements, regarding the Company’s business and losses and to Note 4 of the financial statements regarding significant events during the period of report which include, *inter alia*, a financing arrangement with the banks. The Company’s ability to meet its financial obligations is conditional on meeting new financial covenants during 2010 as set forth in Note 4. In addition we direct attention to Note 1 the turnaround plan that the Company is implementing, and in the opinion of the Company’s Management and Board of Directors, there are good chances improvements in its framework.

Haifa,
August 17, 2010

Kost, Forer, Gabbay & Kasierer
Certified Public Accountants

Consolidated balance sheet

	<u>As of June 30,</u>		<u>As of</u>
	<u>2010</u>	<u>2009</u>	<u>December</u>
	<u>\$ in thousands</u>		<u>31,</u>
<u>ASSETS</u>			
<u>CURRENT ASSETS</u>			
Cash and cash equivalents	\$ 439	\$ 837	\$ 1,904
Short-term investments	700	1,188	737
Trade receivables, net	13,634	24,123	14,597
Other current assets	2,865	3,616	2,892
Inventories	18,451	21,452	19,778
	<u>36,089</u>	<u>51,216</u>	<u>39,908</u>
<u>NON-CURRENT ASSETS</u>			
Deferred taxes, net	1,181	2,100	1,409
Property, plant and equipment, net	53,446	60,643	56,920
Goodwill and other intangible assets, net	757	1,710	960
	<u>55,384</u>	<u>64,453</u>	<u>59,289</u>
	<u>\$ 91,473</u>	<u>\$ 115,669</u>	<u>\$ 99,197</u>
<u>LIABILITIES AND EQUITY</u>			
<u>CURRENT LIABILITIES</u>			
Short-term loans (including current portion of long term - loans)	\$ 4,760	\$ 25,259	\$ 25,847
Trade payables	14,048	16,875	15,042
Other current liabilities	4,199	5,619	5,666
	<u>23,007</u>	<u>47,753</u>	<u>46,555</u>
<u>NON-CURRENT LIABILITIES</u>			
Long-term loans	19,802	-	-
Employee benefits, net	430	1,550	729
Deferred taxes, net	1,053	1,166	3,080
Other non-current liabilities	1,233	5,429	1,838
	<u>22,518</u>	<u>8,145</u>	<u>5,647</u>
<u>EQUITY ATTRIBUTABLE TO OWNERS OF THE PARENT</u>			
Share capital	10,351	7,518	7,518
Additional paid-in capital	108,852	107,460	107,522
Accumulated deficit	(65,915)	(48,214)	(60,666)
Treasury shares	(7,408)	(7,408)	(7,408)
Other capital reserves	68	415	29
	<u>45,948</u>	<u>59,771</u>	<u>46,995</u>
Total	<u>\$ 91,473</u>	<u>\$ 115,669</u>	<u>\$ 99,197</u>

TEFRON LTD

Consolidated statements of income

	Six months ended June 30,		Three months ended June 30,		Year ended December 31
	2010	2009	2010	2009	2009
	Unaudited				Audited
	In dollars thousands				
	(Excluding loss per share)				
Sales	\$ 50,719	\$ 72,245	\$ 24,946	\$ 25,260	\$ 115,538
Cost of sales	48,159	68,360	23,330	26,840	119,339
Gross profit (loss)	2,560	3,885	1,616	(1,560)	(3,801)
Selling and marketing expenses	6,596	7,787	2,951	3,280	13,842
General and administrative expenses	1,798	2,093	924	802	3,779
Other revenues	-	-	-	-	(496)
Operating loss	(5,834)	(5,995)	(2,259)	(5,662)	(20,926)
Loss from the early repayment of a subordinated note receivable	-	-	-	-	(1,285)
Financial income	271	2,155	271	332	1,747
Financing expenses	(1,179)	(2,095)	(641)	(766)	(2,259)
Financial income (expenses), net	(908)	60	(370)	(434)	(512)
Loss before taxes on income	(6,742)	(5,935)	(2,629)	(6,096)	(22,723)
Tax benefit	1,493	1,460	634	1,476	5,330
Loss	<u>\$ (5,249)</u>	<u>\$ (4,475)</u>	<u>\$ (1,995)</u>	<u>\$ (4,620)</u>	<u>\$ (17,393)</u>
Basic and diluted loss	<u>\$ (2.0)</u>	<u>\$ (2.1)</u>	<u>\$ (0.6)</u>	<u>\$ (2.2)</u>	<u>\$ (8.1)</u>

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

Consolidated statements of comprehensive income

	Six months ended June 30,		Three months ended June 30,		Year ended December 31
	2010	2009	2010	2009	2009
	Unaudited				Audited
	In dollars thousands				
Net loss for the period	\$ (5,249)	\$ (4,475)	\$ (1,995)	\$ (4,620)	\$ (17,393)
Other comprehensive loss (net of the tax effect):					
Realized loss (gain) on cash flow hedges, net	(115)	(23)	100	21	(23)
Unrealized gain from cash flow hedges, net	-	74	-	586	115
Unrealized loss on available for sale securities	(36)	341	(36)	39	(86)
Actuarial loss due to defined benefit program	-	-	-	-	466
Total other comprehensive income (loss), net	(151)	392	64	646	472
Total comprehensive loss relating to the Company' shareholders	\$ (5,400)	\$ (4,083)	\$ (1,931)	\$ (3,974)	\$ (16,921)

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

Consolidated statements of changes in shareholders' equity

	Attribute to equity holders of the parent							Total equity
	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for available for sale	Capital reserve for cash flow hedges	Capital reserve for transactions with a controlling shareholder	
	Dollars thousands							
<u>Balance as of January 1, 2010 (audited)</u>	7,518	107,522	(60,666)	(7,408)	(86)	115	-	46,995
Total comprehensive loss	-	-	(5,249)	-	(36)	(115)	-	(5,400)
Share-based payment to employees	-	350	-	-	-	-	-	350
Rights offering (less issue expenses net of \$187 thousand)	2,833	980	-	-	-	-	-	3,813
Capital benefit from a transaction with a controlling shareholder	-	-	-	-	-	-	190	190
<u>Balance as of June 30, 2010 (unaudited)</u>	<u>10,351</u>	<u>108,852</u>	<u>(65,915)</u>	<u>(7,408)</u>	<u>(122)</u>	<u>-</u>	<u>190</u>	<u>45,948</u>

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

Consolidated statements of changes in shareholders' equity

	Attribute to equity holders of the parent							
	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for hedging transactions	Total	Options for shares in a subsidiary	Total capital
	Audited							
	Dollars thousands							
Balance as of January 1, 2009 (audited)	7,518	107,104	(43,739)	(7,408)	23	63,498	247	63,745
Total comprehensive income (loss)	-	-	(4,475)	-	392	(4,083)	-	(4,083)
Share-based payment	-	356	-	-	-	356	-	356
Cancellation of options to an employee in a subsidiary	-	-	-	-	-	-	(247)	(247)
Balance as of June 30, 2009 (unaudited)	<u>7,518</u>	<u>107,460</u>	<u>(48,214)</u>	<u>(7,408)</u>	<u>415</u>	<u>59,771</u>	<u>-</u>	<u>59,771</u>

	Attribute to equity holders of the parent							
	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Capital reserve for transactions with controlling shareholders	Total capital
	Dollars thousands							
	Dollars thousands							
Balance as of April 1, 2010 (Unaudited)	10,351	108,782	(63,920)	(7,408)	(86)	(100)	190	47,809
Total comprehensive income (loss)	-	-	(1,995)	-	(36)	100	-	(1,931)
Share-based payment	-	70	-	-	-	-	-	70
Balance as of June 30, 2010 (Unaudited)	<u>10,351</u>	<u>108,852</u>	<u>(65,915)</u>	<u>(7,408)</u>	<u>(122)</u>	<u>-</u>	<u>190</u>	<u>45,948</u>

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

Attribute to equity holders of the parent

	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Other capital reserves	Total	Options for shares in a subsidiary	Total equity
Dollars thousands								
Balance as of April 1, 2009 (audited)	7,518	107,161	(43,594)	(7,408)	231	63,446	247	63,693
Total comprehensive income (loss)	-	-	(4,620)	-	646	(3,974)	-	(3,974)
Share-based payment	-	299	-	-	-	299	-	299
Cancellation of options to an employee in a subsidiary	-	-	-	-	-	-	(247)	(247)
Balance as of June 30, 2009 (unaudited)	<u>7,518</u>	<u>107,460</u>	<u>(48,214)</u>	<u>(7,408)</u>	<u>415</u>	<u>59,771</u>	<u>-</u>	<u>59,771</u>

Relating to the Company's shareholders

	Share capital	Additional paid-in capital	Accumulated deficit	Treasury shares	Capital reserve for financial assets available for sale	Capital reserve for hedging transactions	Total	Options for shares in a subsidiary	Total equity
Audited									
Dollars thousands									
Balance as of April 1, 2009 (audited)	7,518	107,104	(43,739)	7,408	-	23	63,498	247	63,745
Total comprehensive income (loss)	-	-	(16,927)	-	(86)	92	(16,921)	-	(16,921)
Share-based payment	-	171	-	-	-	-	171	-	171
Cancellation of options to an employee in a subsidiary	-	247	-	-	-	-	247	(247)	-
Balance as of June 30, 2009 (unaudited)	<u>7,518</u>	<u>107,460</u>	<u>(60,666)</u>	<u>(7,408)</u>	<u>(86)</u>	<u>115</u>	<u>46,995</u>	<u>-</u>	<u>46,995</u>

Consolidated statements of cash flows

	For the six months ended June 30,		For the three months ended June 30,		For the year ended December 31
	2010	2009	2010	2009	2009
	Unaudited				Audited
	In dollars thousands				
<u>Cash flows from operating activities</u>					
Loss	(5,249)	(4,475)	(1,995)	(4,620)	(17,393)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Adjustments to the profit or loss items:					
Depreciation of fixed assets and intangible assets	4,541	4,481	2,201	2,268	9,256
Impairment (reversal of impairment) of property, plant and equipment and intangible assets	-	-	-	-	(496)
Inventories wReite-off	666	860	369	380	2,808
Extinguishment of contingent consideration (A)	-	-	-	-	(399)
Share-based payments	140	109	70	52	171
Loss (gain) on sale of property, plant and equipment	(31)	(17)	(27)	-	(17)
Deferred taxes, net	(1,619)	(1,468)	(634)	(1,259)	(5,364)
Change in liabilities for benefits to employees, net	(299)	(619)	(218)	137	(850)
Loss from early repayment of a subordinated bond	-	-	-	-	1,285
Taxes on income	83	638	51	399	1,427
Financing expenses	543	307	406	51	723
	<u>4,024</u>	<u>4,291</u>	<u>2,218</u>	<u>2,028</u>	<u>8,544</u>
<u>Changes in items of assets and liabilities:</u>					
Decrease (increase) in trade receivables	963	(677)	1,340	6,472	8,849
Decrease (increase) in other receivables	(79)	1,499	215	1,000	1,497
Decrease in inventory	660	9,813	2,527	4,194	9,730
Decrease in trade payables	(994)	(8,292)	(4,167)	(7,894)	(10,125)
Decrease in other payables	(2,888)	(2,160)	(1,374)	(1,061)	(428)
	<u>(2,338)</u>	<u>183</u>	<u>(1,459)</u>	<u>2,711</u>	<u>9,523</u>
<u>Cash paid and received during the year for:</u>					
Interest paid	(543)	(245)	(406)	(20)	(878)
Interest received	-	32	-	16	155
Taxes paid	(83)	(638)	(51)	(399)	(1,427)
	<u>(626)</u>	<u>(851)</u>	<u>(457)</u>	<u>(403)</u>	<u>(2,150)</u>
Net cash used for operating activities of the Company	<u>(4,189)</u>	<u>(852)</u>	<u>(1,693)</u>	<u>(284)</u>	<u>(1,476)</u>

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

Consolidated statements of cash flows

	For the six months ended June 30,		For the six months ended June 30,		For the year ended December 31
	2010	2009	2010	2009	2009
	Unaudited				Audited
	In dollars thousands				
<u>Cash flows from investing activities</u>					
Acquisition of fixed assets	(41)	(305)	(19)	(73)	(611)
Acquisition of intangible assets	(2)	(40)	(1)	(14)	(75)
Pending consideration paid	-	-	-	-	(271)
Proceeds from realizing fixed assets	41	18	37	-	18
Proceeds from early repayment of a subordinate bond	-	-	-	-	1,715
Net cash provided by (used for) investing activities	(2)	(327)	17	(87)	776
<u>Cash flows from financing activities</u>					
Purchase of property, plant and equipment	(9,486)	2,526	1,789	2,035	4,923
Repayment of long-term loans	(11,601)	(2,076)	-	(1,038)	(3,885)
Receipt of long-term loans	20,000	-	-	-	-
Proceeds from the issue of rights, net	3,813	-	-	-	-
Net cash provided by (used for) financing activities	2,726	450	1,789	997	1,038
<u>Increase (decrease) in cash and cash equivalents</u>	(1,465)	(729)	113	626	338
<u>Balance of cash and cash equivalents at beg. of year</u>	1,904	1,566	326	211	1,566
<u>Balance of cash and cash equivalents at end of year</u>	439	837	439	837	1,904
(A) <u>Significant non cash transactions</u>					
Extinguishment of contingent consideration against goodwill	-	-	-	-	344
Granting of options in the framework of rescheduling of loans	210	-	-	-	-

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

Notes to the interim consolidated financial statements

Note 1 – General

- a. These financial statements were prepared in a condensed format, as of June 30, 2010 and for the period of six months then ended (hereinafter – Interim Consolidated Financial Statements). These statements should be studied in conjunction with the Company's annual financial statements as of December 31, 2009 and for the year then ended, and the notes accompanying them (hereinafter – Annual Financial Statements).
- b. During the fourth quarter, the Company started a turnaround program to improve its business results (hereinafter: "the turnaround program"). Correct as of signing this report, operating improvements occurred on the production floor, such as: a shortening of leased time to customers and a decrease in waste during the production process, a decline in the costs basis of the Company; such as: in the manpower clause, rent and transportation. In the opinion of the Company's Board of Directors, there are good chances to have improvements in the framework of the turnaround program.
- c. The Company had losses of \$ 5,249 thousand for the six months period ended June 30, 2010. Moreover, during the six months period ended June 30, 2010, the Company had negative cash flows from operating activities of \$ 4,189 thousand.

Due to the global economic crisis, the decline in demand and the continued accumulation of considerable losses, the Company requires additional financing sources. During March 2010, through an issue of rights to shareholders and a private placement as mentioned in Note 4c, the Company raised a gross total of \$ 4 million. In addition, on March 2, 2010, the Company signed an agreement with the banks regarding the reorganization of credit lines and new undertakings to the banks, as detailed in Note 4b. Furthermore, the Company is examining off-bank financing possibilities such as the start of working with factoring companies enabling obtaining advance of payments from customers. It is uncertain that the Company will succeed to come to an agreement and start work with these factoring companies

Note 2 – Significant accounting principles**Form of preparation of interim consolidated financial statements**

The interim consolidated financial statements are prepared in accordance with the generally accepted accounting principles for the preparation of financial statements for interim periods, as set forth in International Accounting Standard 34 – Financial Reporting for Interim Periods, and according to the provisions of the pronouncement according to Chapter D of the SecuReities Regulations (Periodic and Immediate Report) – 1970.

The significant accounting principles and method of calculation, implemented in the preparation of the interim consolidated financial statements, are consistent with those implemented in the preparation of the annual financial statements, excluding the following:

Notes to the interim consolidated financial statements

Note 2 – Significant accounting principles (contd.)**IAS 36 - Impairment in value of assets**

The amendment to IAS 36 (hereinafter - the amendment) what the accounting unit is, which requires goodwill to be allocated to it, in order to examine an impairment in value of goodwill. According to amendment, the largest unit possible full allocating goodwill purchased in the business combination is the operating segment as defined in IFRS 8 - operating segments, prior to consolidate and import reporting purposes. The amendment is applied 'as from the financial statements for periods starting January 1, 2010.

The amendment did not have a significant effect on the Company's financial position, results operations and cash flows.

IAS 17 - Leasing

According to the amendment to IAS 17 the specific directive regarding the method of classifying leasing of land in an operative or financial leasing was cancelled. Accordingly, there is no longer a demand to classify leasing of land as an operative leasing. In every case in which the ownership is not expected to be transferred to the lessee at the end of the lease period, that the classification of leasing of land must be examined in accordance with the general directives appearing in IAS 17 which relate to the classification of operative leasing pool with financial leasing from the date of signing the original agreement with the Israel Lands Administration, while considering that land generally has a infinite economic life span. Therefore the leasing of land from the Israel Lands Administration will be examined while making a comparison between the present value of the amount recorded as prepaid expenses for the operative leasing and the fair value of the land.

The amendment did not have an effect on the Company's financial position, results of operations and cash flows.

Form of preparation of interim consolidated financial statements (contd.)

The Group does not recognize assets and liabilities for future payments which will apply on exercising the option to extend the leasing period, as these payments will be based on the fair value of the land on future realization and which comprise contingent leasing fees, which in accordance with IAS 17 should not be taken into account.

Disclosure to New IFRS Standards during the period prior to its implementation**IFRS 9 – Financial Instruments**

In November 2009, IFRS 9 – Financial Instruments, was published, which is the first stage of the project of replacing IAS 39 – Financial Instruments: Recognition and Measurement. IFRS 9 focuses mainly on the classification and measurement of financial assets and it applies to the financial assets on which IAS 39 applies.

Notes to the interim consolidated financial statements

The Standard stipulates that at the time of first recognition all financial assets (including hybrid instruments in which the hosting contract is a financial asset) will be measured at fair value. During subsequent periods, the debt instrument must be measured at reduced cost only if both following conditions exist:

- The asset is held in the framework of a business model, whose purpose is to hold assets so as to collect the contractual cash flows resulting from them.
- According to the contractual terms of the financial asset, the Company may, on certain dates, receive cash flows comprising only payments of principal and payments of interest on the on the balance of the principal.

The subsequent measurement of all the other debt instruments and other financial asset instruments will be at fair value.

Financial assets which are capital instruments will be measured during subsequent periods at fair value, and the differences will be recorded to the statement of income or to other comprehensive income (loss), according to the choice of the accounting principles regarding every single instrument. If this relates to capital instruments held for trading purposes, it is compulsory to measure them at fair value through the statement of income. The choice is final and cannot be changed. Nevertheless, when a company changes its business model to manage financial assets, it must reclassify all the financial instruments affected from the change in the business model so as to reflect this change. In all the other circumstances, no reclassification of financial instruments must be made.

The date of the start of the Standard is January 1, 2013. Earlier implementation is possible. First implementation will be done retrospectively by restating the comparative figures, subject to certain exemptions mentioned in the Standard.

The Company is examining the possible effect of the new standard, although it will is not able, at this stage, to estimate its effect, if any, on the financial statements.

Notes to the interim consolidated financial statements

Note 2 – Significant accounting principles (contd.)**Disclosure to New IFRS Standards during the period prior to its implementation (contd.)****IFRS 7 – Financial Instruments: Disclosure**

The amendment to IFRS 7 clarifies the disclosure requirements in the Standard. In accordance with the Standard, the connection between the quantitative and qualitative clarifications and the nature and level of risks stemming from financial instruments is emphasized. Disclosure requirements were minimized regarding guarantees that the Company holds and the demands for disclosure regarding credit risks were amended. The amendment will be implemented retrospectively starting from the financial statements for the periods starting January 1, 2011 - earlier implementation is possible.

In the Company's opinion, the amendment is not expected to have a significant effect on the disclosure on the financial statements in the financial statements.

IAS 1 – Presentation of the financial statements

According to the amendment, it is possible to present the movement between the opening balance and the closing balance for every component of other comprehensive income in the statement of changes in capital or in the context of the notes to the annual financial statements. The amendment will be implemented retrospectively starting from the financial statements for the periods starting January 1, 2011 - earlier implementation is possible.

The amendment is not expected to have a significant effect on the Company's financial statements.

Note 3 – Seasonality

The Company's intimate apparel and active wear products are not affected by seasonality. In the swimwear products, most of the Company's sales are carried during the months of December to May. The results of operations should be studied considering this seasonality.

Note 4 – Significant events during the period of report**a. The appointment of a new CEO**

1. On January 17, 2010, the Company Board of Directors approved the Company's engagement in the employment contract with the Company incoming CEO, Mr. Amit Meridor, as from January 21, 2010.

Note 4 – Significant events during the period of report (contd.)

a. The appointment of a new CEO (contd.)

2. Share-based payment cost

On January 17, 2010, the Company's Board of Directors approved, further to the approval of the Company's Audit Committee, a grant of 100,000 option warrants which can be exercised to 100,000 ordinary shares of NIS 10 par value each to the Company's CEO. The allotment of the option warrants to the CEO was done in accordance with the options plan for the Company's employees, officers and consultants, which was approved by the Company's Board of Directors in September 1997 and as amended in January 2003. The entitlement to exercise the options occurs over a three-year period from the date of the start of the employment of the CEO and expires ten years after the granting. The market value of the Company's share on the date of granting was 4.0 dollars. The exercise price of the option warrants was set at an amount of 3.80 dollars; therefore, during the period of report, the Company recorded expenses of 23 thousand dollars which are presented in general and administrative expenses.

The following are data used for measuring the fair value of the options per shares:

Dividend yield for the share (%)	0.0	
Expected fluctuations in the share prices (%)	53.2	
Rate of interest without risk (%)	2.6	
The forecasted lifespan of the options for shares (years)	6	
will Weighted average of the share prices (dollars)		5.1

b. Final agreement with the banks that finance the Company relating to the Company's credit lines

On March 2, 2010, the Company signed a final agreement with the banks which includes a reorganization of the credit financing that the banks provide in favor of the Company. The Company implemented the provisions of IAS 39 (while examining the quantitative and qualitative cReiteria) and handled it in the new arrangement as a non significant change of conditions

The following is a summary of the main provisions of the signed agreement:

The credit framework which will be provided in favor of the Company will be divided into the following loans and credit lines:

1. Loan A'

The principal of Loan A' will be for a total amount of \$15,000,000 will be provided by the banks for a ten-year period. The interest on Loan A' will be paid quarterly and the principal of Loan A' will be repaid in three equal installments of \$1,250,000 each, as from the end of the seventh, eighth, and ninth year after the date of providing the loan.

The balance of \$11,250,000 will be repaid at the end of the tenth year after the date of providing Loan A, pro rata between the banks.

Note 4 – Significant events during the period of report (contd.)

b. Final agreement with the banks that finance the Company relating to the Company's credit lines (contd.)

1. Loan A' (contd.)

Early repayment of Loan A'

The Company will make an early repayment of the unpaid balance of Loan A', fully or partly, in those cases conditions and dates as detailed below:

- (1) Future raising of capital – in every case where the Company will raise capital, then a total comprising 50% (fifty percent) of the net consideration from raising of capital will be used make an early repayment.
- (2) Sale of assets - in every case where the Company will sell an asset, not in the normal course of business, then the full net consideration from the sale of the asset will be used to make an early repayment.
- (3) Surplus cash flows – in every case where the total surplus cash flows, according to the financial statements, will exceed an amount set at 8,000,000 dollars, then the total comprising 50% of the difference between the surplus cash flows and the said total will be used to make an early repayment, according to the determining ratio, on account of the last payment of Loan A'.

"Surplus cash flows" – the Company's total EBITDA according to the financial statements, in every calendar year, less: (a) total interest costs of the companies for that calendar year; and (b) the total investment that the Company made in the framework of its operations and the current maintenance for that calendar year (hereinafter: "current investments"). The companies will make current investments, including in the normal course of business, of an annual accumulated amount, for every company, exceeding \$2,000 thousand.

2. Loan B'

The principal of Loan B' will be a total amount of \$5,000,000 which will be provided by the banks for a six-year period. The interest will be paid quarterly and the principal will be repaid in four equal installments of \$1,250,000, each, at the end of each of the second, third, fourth, fifth, and sixth years after the provision of Loan B' by the banks.

3. Short-term frameworks (in addition to loans A' and B')

The banks will provide the Company with short-term credit frameworks of up to a year for a total amount of \$8,950,000, under the following conditions:

Notes to the interim consolidated financial statements

Note 4 – Significant events during the period of report (contd.)**b. Final agreement with the banks that finance the Company relating to the Company's credit lines (contd.)**4. Infusion of capital

The Company undertook to make an issue of rights and/or a private placement of shares, in the framework of which an amount of not less than \$4,000,000 (less expenses) will be invested in the Company's shareholders' equity, and this by June 30, 2010.

Correct as of March 28, 2010, the Company completed the issue of rights and a private placement to Norfet and/or anyone on its behalf, in the framework of which it raised \$4 million.

5. Providing additional credit frameworks

Subject to completing the infusion of capital, fully and in due time, the banks will provide the Company with additional short-term credit lines for a total amount of \$1,800,000.

6. Additional undertakings

In addition to the collateral and the undertakings in the agreement, the Company undertook, inter alia, that as long as Loan A' and Loan B' have not yet fully repaid to the banks, it will not pay nor undertake to pay any dividends to its shareholders without the banks' prior written agreements.

Capital Benefit

The Company undertook to allot to the banks, gratis, not later than the end of 30 days from the date of signing the agreement a total quantity of 100,000 option which can be exercised to 100,000 ordinary shares of NIS 10 par value each of the Company, against a payment of an exercise price of \$4.50 for every share. The options can be exercised (fully or partly) for a 48-month period from the date of signing the agreement. A benefit of \$ 210 dollars was presented in the financial statements. On August 17, 2010, the allotment of the options, as mentioned above.

Financial covenants

The banks gave their consent not to activate their rights vis-à-vis the Company due to the Company's expectation not to meet the financial covenants that it undertook to meet in 2009, according to Tefron's financial statements of December 31, 2009 only.

Notes to the interim consolidated financial statements

Note 4 – Significant events during the period of report (contd.)**b. Final agreement with the banks which finance the Company relating to the Company's credit lines (contd.)****6. Additional undertakings (contd.)**

In addition, in 2010 the Company undertook to meet at all time all the financial covenants and undertakings, as detailed below:

- 1) According to the Company's consolidated financial statements for 2010, the Company's EBITDA will be positive; (this covenant was changed on July 11, 2010 to EBIDTA which will not be less than minus \$2.1 million); and
- 2) According to the Company's consolidated financial statements (the quarterly and the annual) the Company's shareholders' equity will not be less than 35 million dollars; and
- 3) According to the Company's consolidated financial statements (the quarterly and annual), the total amount of cash balances, inventories, and receivables will not be less than 33 million dollars; and
- 4) According to the Company's consolidated financial statements (the quarterly and annual), the Company's receivable balances will not be less than 9 million dollars;
- 5) The CEO and Chairman of the Board in any of the companies of the Tefron Group will not earn a salary exceeding the CEO's salary or that of the Board, whichever relevant, in a relevant company, as exists on the date of signing the agreement, plus linkage difference to the consumer price index.

By November 30, 2010, the companies and the banks will agree among themselves what are the additional financial covenants and undertakings, including relating to the restriction of salaries of officers of the Company, which the Company must meet as from January 1, 2011. Should the companies and the bank not reach such an agreement by November 30, 2011, the companies must meet the financial covenants they undertook to meet prior to the date of signing the agreement. Up to December 31, 2009, the banks' credit agreement included financial covenants which contain maintaining the following financial ratios:

1. Shareholders' equity of not less than 40 million dollars.
2. Rate of shareholders' equity to the total balance sheet will not be less than 20%.
3. The ratio between the Company's total liabilities to banks and EBITDA will not exceed 9.5.

Notes to the interim consolidated financial statements

Note 4 – Significant events during the period of report (contd.)**b. Final agreement with the banks which finance the Company relating to the Company's credit lines (contd.)****6. Additional undertakings (contd.)**

Prior to signing the final agreement, on December 2, 2009, the Chairman of the Company's Board of Directors and the Company's CFO received verbal notices from three banks, with which the Company has financing agreements, according to which each of the banks decided to stop utilization of the Company's credit lines.

To the best of the Company's knowledge, the banks' decision regarding stoppage of utilizing the Company's credit lines is as a result of the banks' evaluations that the Company will continue to present losses in the coming periods. The banks' decision was taken suddenly despite the fact that for the purpose of the Company's financial statements as of December 31, 2008, as of June 30, 2009 and as of June 30, 2009, the banks gave the Company a waiver of their right for immediate repayment of the credit provided in favor of the Company despite the Company's losses and the Company not meet one of the financial covenants (relating to the EBITDA) are included in the financial agreement between the Company and the banks.

According to the provisions of IAS 39, the Company has examined whether the conditions of the various new debt arrangements are significantly different from the original financial undertakings. The changes in the conditions were insignificant and therefore the Company did not make any change in the value of its financial liabilities in the books on the date of the change.

c. Issue of rights to a prospectus, a shelf prospectus and a private placement

On February 26, 2010, the Company published a prospectus for issuing rights to the SecuReities Exchange Commission in the US, and a prospectus for issuing rights to the SecuReities AuthoReity and to the Tel Aviv Stock Exchange. In the prospectus, the Company published an offer to the public by way of rights of 1,578,975 ordinary shares, of a nominal value of NIS 10 each of the Company, offered at a price of 3.80 dollars per share. The shares were offered by way of rights to the Company's shareholders, according to the ratio of 1 credit unit for every 1.406 shares.

After Norfet announced to the Company that it was unable to participate in the issue of rights due to regulatory constraints, the Company chose to raise this amount through combined steps of issuing rights and carrying out a supplementary private placement to Norfet and/or anyone on its behalf (hereinafter: "Norfet"), where Norfet undertook to invest in the Company against an allotment of a private placement of shares, an amount which will supplement the total raising amount of the Company in the framework of the issue of rights and the allotment of a private placement to Norfet, to 4 (four) million dollars.

Notes to the interim consolidated financial statements

Note 4 – Significant events during the period of report (contd.)**c. Issue of rights prospectus, a shelf prospectus and a private placement (contd.)**

In the framework of the issue of rights, the Company raised an amount of 2,867 thousand US dollars from its shareholders against the allotment 754,384 ordinary shares of the Company. In the framework of the private placement, the Company raised an additional amount of \$1,133 thousand. During March 2010, the Company raised a total gross amount of \$4 million.

Furthermore, in February 26, 2010, the Company published a shelf prospectus for:

- (a) Up to 3,000,000 ordinary shares of NIS 10 par value each of the Company;
- (b) Up to 10 series of convertible bonds, where each of the series of these bonds will have a total par value of NIS 500,000,000 and which are repayable in one payment or in a number of equal installments;
- (c) Up to 10 series of option warrants, where each of the series of these option warrants will include not more than 3,000,000 option warrants which can be exercised in such a way that each option warrant can be exercised to 1 ordinary share of NIS 10 par value of the Company against a cash payment of the exercise price linked to the index;
- (d) Up to 10 series of option warrants, where each of the series of these option warrants will include not more than 200,000,000 option warrants which can be exercised in such a way that every option warrant can be exercised to NIS 100 par value of bonds of Series A' to K' of the Company, against a cash payment of the exercise price linked to the consumer price index; and of –
- (e) Up to 10 series of marketable secuReities (Series 1 to 10) where each of these marketable secuReities will have a par value of NIS 500,000,000 which are repayable in one or more payments.

d. Lease agreement with REIT 1

On March 21, 2010, the Company signed an agreement with REIT 1 Ltd. (hereinafter: "REIT 1") which is the owner of rights in three industrial buildings in the industrial area of Terodion (hereinafter: "the buildings"), in which the Company's plants and head office are located. According to the provisions of the agreement, the Company paid the full debt to REIT 1, vacated the head office building, continues to lease the 1 and 2 Hi-Tex buildings until December 31, 2019 and on August 17, 2010 allotted Reit 1 60,000 option which can be exercised to 60,000 ordinary shares of NIS 10 par value each of the Company, against a payment of an exercise price of \$4.50 for every share. Options can be exercised (fully or partly) for a 48-month period from the date of they were allotted.

Notes to the interim consolidated financial statements

Note 5 – Business segments**a. General**

The companies in the Group are engaged in two operating business segments:

Seamless apparel ("Seamless") - The design, development, production, and sale of intimate apparel and active wear, using the "Seamless" method;

Knitted apparel (Cut & Sew) - The design, development, production and sale of underwear, swimwear and sportswear using the "Cut & Sew" method. The design and production are done mainly in Israel, in Jordan, and in the Far East, while the sale of the finished product is carried out mainly in the US and in Europe.

The Company's two operating segments are carried out in a number of main geographic regions in the world. In Israel, the Company's place of residence and of its subsidiaries – Hi-tex founded by Tefron Ltd., and Macro Apparel Ltd. carry out the design, development, production and sale of underwear, sportswear and swimwear. The subsidiaries Tefron U.S and Tefron England carry out marketing and selling operations.

The information that the Company reports according to the definitions of IFRS 9 is based on available financial information which is regularly reviewed and serves the chief operating decision maker in the Company (CODM) in order to make decisions regarding resources to be allotted to the segments and to evaluate the segment's performance. The chief operating decision maker in the Company is the CEO. Based on the criteria in IFRS 8 to determine reportable operating segments and the financial information available and reviewed by the Company's CEO, the Company decided that it operates in two reportable operating segments.

The financing of the Group (including financing costs and financing revenues) and taxes on income are managed on a group basis and do not related to the operating segments.

Notes to the interim consolidated financial statements

Note 5 – Business segments**b. Reporting regarding operating segments**

	Six months ended June 30, 2010		
	Seamless	Cut & Sew	Total
	Unaudited		
Dollars thousands			
External revenues	23,563	27,156	50,719
Segment results	(5,618)	(216)	(5,834)
Financing expenses, net			(908)
Tax benefit			1,493
Loss			(5,249)

	Six months ended June 30, 2009		
	Seamless	Cut & Sew	Total
	Unaudited		
Dollars thousands			
External revenues	34,950	37,295	72,245
Segment results	(4,780)	(1,215)	(5,995)
Financing income, net			60
Taxes on income			1,460
Net earnings			(4,475)

	Three months ended June 30, 2010		
	Seamless	Cut & Sew	Total
	Unaudited		
Dollars thousands			
External revenues	12,139	12,807	24,946
Segment results	(2,043)	(216)	(2,259)
Financing expenses, net			(370)
Tax benefit			634
Loss			(1,995)

Notes to the interim consolidated financial statements

Note 5 – Business segments

b. Reporting regarding operating segments

	Three months ended		
	June 30, 2009		
	Seamless	Cut & Sew	Total
	Unaudited		
	Dollars thousands		
External revenues	13,299	11,961	25,260
Segment results	(3,713)	(1,949)	(5,662)
Financing income, net			(434)
Taxes on income			1,476
Net earnings			(4,620)

	For the year ended		
	December 31, 2009		
	Seamless	Cut & Sew	Total
	Unaudited		
	Dollars thousands		
External revenues	62,306	53,232	115,538
Segment results	(13,197)	(7,729)	(20,926)
Other expenses			(1,285)
Financing expenses, net			(512)
Tax benefit			5,330
Loss			(17,393)

Note 6 – Events after the balance sheet

a. Appointment of a new Chairman of the Board

On July 5, 2010, Mr. Arnon Tieberg was appointed to the position of Company's Chairman of the Board of directors. Mr. Yaakov Gelbard, the former Chairman of the Board of directors, ended his function on July 5, 2010.

b. Receipt of a waiver from the bank lenders

On July 11, 2010, the Company received a waiver from the three bank lenders. In the framework of the waiver, the accompanying banks notified the Company that the objective of the EBITDA was changed, from a positive EBITDA in 2010 to an EBITDA which will not be less than 2.1 million dollars for 2010.
