



**Prospectus**

**April 2000**



**Announcement Concerning English Translation of Össur's Prospectus**

This document is a translation made in December 2000 of Össur's prospectus dated April 2000. The translation of this document is made for information purposes only and does not constitute an offer for sale of securities. It should not be relied upon by any person for any other purpose. This English translation has not been reviewed by the Icelandic Stock Exchange or its employees. Should there arise a disagreement over the contents of the prospectus, the text of the Icelandic document is the definite one.

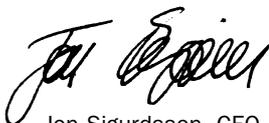
# Statements of Issuer, Underwriter, and Auditors

## Issuer's Statement

The Chief Executive Officer, on behalf of the Board of Directors of Össur hf., registration no. 560271-0189, Grjóthals 5, 110 Reykjavík, hereby proclaims that this prospectus is made according to the best of our knowledge, in full conformity with all facts, and that no material factor relevant to an evaluation of the shares that will be sold in this offering has been omitted.

Reykjavik, April 11, 2000

On behalf of the Board of Directors of Össur hf.



Jon Sigurdsson, CEO

ID no. 290656-3549

Klapparstigur 35, 101 Reykjavík

## Underwriter's Statement

The underwriter of this issue of Össur hf. shares is Kaupthing hf., registration no. 560882-0419, Armuli 13A, 108 Reykjavik.

Kaupthing hf. has, in cooperation with the directors of Össur hf., filed this prospectus based on information from the Company and its chartered auditors. Kaupthing has gathered the relevant and necessary information for the prospectus, following its own estimate, to give a true view of the issuer and of the shares filed for registration. Kaupthing proclaims that this prospectus is made according to the best of its knowledge and in full conformity with the facts. In Kaupthing's opinion, the prospectus gives a clear view of the operations and the financial status of Össur and no significant factors have been omitted that can influence the evaluation of the Company or its shares.

Reykjavik, April 11, 2000

On behalf of Kaupthing hf.



Sigurdur Einarsson, CEO

ID no. 190960-2269

Valhusabraut 20, 170 Seltjarnarnes

## Auditor's Statement

We, the undersigned, have examined and signed without reservation the Financial Statements of Össur hf. and the Consolidated Financial Statements of Össur hf. and its subsidiaries for the years 1997 up to and including 1999. Furthermore, we confirm that all other information in this prospectus, which relates to the Financial Statements, is according to the abovementioned Financial Statements.

Reykjavik, April 11, 2000

**Deloitte & Touche hf.**,  
Chartered Accountants



Arni Tomasson, C.A.

ID no. 251055-7269

Hraunbraut 20, 200 Kopavogur



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ID no. 040446-7499

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## I. The Issuance of Shares and Registration

### **Issuer**

Össur hf., registration no. 560271-0189, Grjóthals 5, 110 Reykjavík. No particular laws concern the Össur operation. The Company operates according to Act no. 2/1995, on Public Limited Liability Companies.

### **Shares Sold in This Offering**

New shares in Össur hf. totaling ISK 60,000,000 nominal value will be issued in this offering. The Company's shareholders hold pre-emptive rights according to Chapter V of law no. 2/1995 on Public Limited Companies.

Net cash flow to issuer regarding the offering is between ISK 3,686.4 – 3,974.4 million. The outcome of the offering shall be used to finance the purchase of Flex-Foot Inc.

### **Issuer's Activities**

The objective of the issuer, according to Article 1.04 of Össur's Articles of Association, is the development and sale of prosthetics and orthotics in the field of disability and rehabilitation technology, as well as all kinds of services to the health sector and patients. Further objectives include the operation of prosthetics repair shops, development and sale of goods for other uses, investment and participation in other companies and other related operations.

### **Underwriter of the Issue**

Kaupthing hf., registration no. 560882-0419, Armuli 13A, 108 Reykjavík.

### **Authorization**

At the Össur general meeting held on March 24, 2000, the Company's Board of Directors was authorized to increase the Company's capital stock over a period of five years to the amount of ISK 70,000,000 in addition to authorizations for an increase that the Board had received previously. New shares will now be issued for ISK 60,000,000 and will be sold in this offering.

### **Registration**

The board of the Iceland Stock Exchange has agreed after the offering to list all Össur hf. shares already issued, a nominal value of ISK 60,000,000, provided that Össur has met all the requirements for listing. The results of the issue will be disclosed in the trading and information system of the Iceland Stock Exchange along with the final date of the listing. The registration is expected to occur in the middle of May 2000.

Listings at other stock exchanges parallel with this listing will not be applied for. Shares of Össur hf. are not listed on exchanges other than the Iceland Stock Exchange, and such a listing has not been requested.

At the beginning of the offer, the nominal value of the shares is ISK 211,937,460, but after the offering it will be ISK 271,937,460. The Company does not own any treasury shares.

Kaupthing hf. underwrites the issue.

#### **Sales Period**

The sales period to pre-emptive rights holders is from April 17 up to and including May 2, 2000, and the general offering is from May 3 up to and including May 5, 2000.

#### **Seller**

Kaupthing hf., registration no. 560882-0419, Armuli 13A, 108 Reykjavik.

#### **Terms of Sale**

This is a sale of ISK 60,000,000 nominal value that will be sold in two stages: to pre-emptive rights holders and to the general public in a common stock offering.

The issue arrangement is such that shareholders can utilize their lawful pre-emptive right for the new shares offered for sale in the abovementioned issue. The shareholders' pre-emptive rights are based on the Company's shareholder register as of April 8, 2000. Should shareholders not utilize all their pre-emptive rights nor endorse them, then other shareholders have pre-emptive rights to the shares in proportion to their holdings. If the new shares are not all sold to the holders of pre-emptive rights, they will be sold in the common stock offering.

Pre-emptive rights holders can utilize their rights during the period of April 17, 2000 to May 2, 2000. The price for pre-emptive rights holders will be ISK 64.

If a common stock offering takes place, it will be during the period May 3–5, 2000. The offering price in the common stock offering will be ISK 69, and participants will have the opportunity to subscribe to shares for a maximum purchase price of ISK 1,035,000.

#### **Payment**

Payment notices will be sent no later than May 19, 2000, and payment is due on June 2, 2000. If payment is not received in the proper manner by the specified time, the debt may be collected in accordance with the law.

#### **Delivery of Shares**

The shares will be issued in electronic form, rather than materially in paper form, by the Icelandic Securities Depository Ltd.

#### **Stock Units**

The Company stock is divided into units of one krona (Icelandic krona) and multiples thereof.

The shares will not be issued in fixed units.

#### **Rights**

There is only one class of Össur shares outstanding, and there are no special rights attached to any of the shares. Shareholders have voting rights at shareholders' meetings as well as the right to a dividend according to the decision of the Annual General Meeting. No restrictions are imposed on the use of shares in the Company. The right to a dividend terminates in four years according to article 3 of law no. 14/1905 on the termination of debts and other claims as stated in article 2.02 in the Company's Articles of Association.

No extraordinary rights accompany the Company's shares.

#### **Dividend Policy**

The Company aim is to invest in its own growth as long as the return of investments in the prosthetics sector is higher than investors are offered in other sectors taking risk into consideration. The Company does not expect to pay dividends in the next few years.

#### **Transfer of Ownership**

The transfer of ownership of the shares, whether by sale, gift, inheritance, settlement of estate or attachment, should always be registered at the Company's office as soon as they occur, and the shareholder register shall then be amended accordingly. In relation to the Company, the shareholder register is considered to be the full proof of owner-

ship of shares of stock in the Company. Dividends, bonus shares, convening notices, and announcements will be sent to the party who at any time is the registered owner of each relevant share in the Company shareholder register. The Company is not responsible for non-delivery of payments or notices because of negligence to notify the Company regarding change in ownership or of residence.

#### **Transfer**

There are no restrictions to the right to transfer shares, and the shareholders are allowed to collateralize their shares in accordance with the law. An individual who acquires a share in the Company cannot utilize his rights as a shareholder unless his name has been recorded in the shareholder register or he has notified and proven his ownership of the share. A transfer shall always be written on the share certificates with a name, identity number, address, and purchasing price.

#### **Electronic Listing**

It is authorized in accordance with the Board decision to issue shares electronically in accordance with the law on the electronic listing of securities.

#### **Dividend Payment**

Should a shareholders' meeting decide upon a dividend payment, it will be paid to shareholders on the day of the Annual General Meeting according to the shareholder register.

#### **Tax Considerations**

Össur hf. has received confirmation from the Director of Internal Revenue that the Company fulfills conditions stated in paragraph 1, article 11 of law no 154/1998 on the Deductibility of the Purchase Price of Shares of Stock for the year 2000.

The stamp duty on all the Company shares will be paid by Össur hf.

The shareholders are liable for tax, and the tax liability of shares is dealt with according to current tax laws at any time.

The issuer must retain withholding tax from dividend payments to shareholders according to paragraph 2,

article 3 of law no. 94/1996 on Withholding Tax on Capital Income.

#### **Expenses**

All costs for the issue will be paid by Kaupthing hf. Kaupthing's commission for managing the offer is 4% of the sales value of the offering.

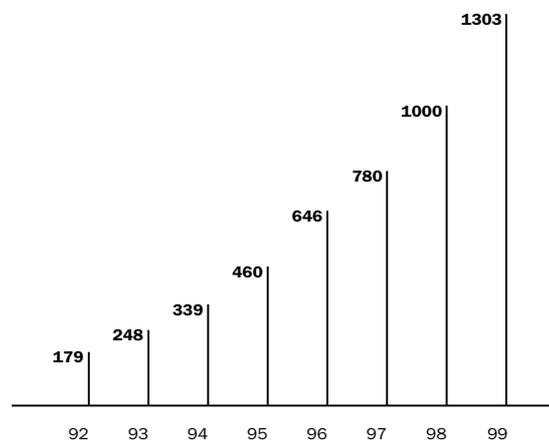
#### **Documents Regarding the Issue**

The prospectus and the registration statements, along with other documents referred to, can be obtained at the Kaupthing hf. offices at Ármúli 13A, Reykjavik, as well as from the Kaupthing website: [www.kaupthing.com](http://www.kaupthing.com).



## II. Össur hf.

Össur hf. was established in 1971 in Reykjavik by various associations for the disabled and by prosthetist Össur Kristinsson. Since 1984, the Company has been fully owned by Össur Kristinsson and his family. In a little over a decade, Össur has developed from being a prosthetics facility with a handful of workers into a progressive high-tech company that designs, produces, and sells components for prosthetic devices while also carrying out significant development and marketing work. In addition, the Company operates a prosthetics facility and a store selling prosthetic and auxiliary devices for the domestic market. The Sales Division in Iceland and Össur hf. subsidiaries in the US and England man-



age the sales and marketing of the Company's products, as well as providing training in product use to the 25 distributors who distribute the devices to over 40 countries.

In 1986, Össur began exporting its products, and about 90% of the total income now derives from exports. As is shown in the graph to the left, Össur's total turnover has grown from ISK 179 million in 1992 to ISK 1.3 billion in 1999.

Education and training in the use of Össur products plays a large role in operations, as the Company's objective has been to develop and produce goods that improve the quality of life for the users and enable them to live normal lives. The design of the products and the potential inherent in them make the rehabilitation process faster and easier.

Since Össur began producing prosthetics, the Company has marketed several new products that have caused a basic change in the making of artificial limbs and work procedures for prosthetists. The main items are ICEROSS, the Icelandic Roll On Silicone Socket, which was marketed in 1986, and the ICEX socket-making technique that was first marketed in 1996. The use of ICEROSS, as well as imitations of it, is already widespread, and the market for such solutions has grown. The ICEX technique enables prosthetists to form a hard socket directly onto the residual limb. This technology has been

well received by the market and, according to Össur's managing executives, will become widespread in years to come. Össur's subsidiary, Flex-Foot/Mauch, is a leader in the use of carbon fibers for artificial heels and revolutionized the market when it presented a new design for artificial heels in 1984. Flex-Foot's artificial heels, as well as the Mauch artificial knees, have become well known as superior products for vigorous individuals whose high level of activity tests the quality of the equipment.

Össur's performance has attracted attention, and the Company has received numerous prizes and trophies. Össur was awarded the Export Prize of the President of Iceland in 1992. Össur was chosen as one of Europe's most progressive companies in 1995, 1997, and 1998 by the Organization of Progressive Entrepreneurs, with the support of the European Union. Össur was nominated for the Design Award of the European Union in 1996 for the ICEX socket technique. Subsequently, the Company was chosen to participate in the finals for the Design Prize of the European Union in 1999. Össur Kristinsson has been awarded numerous acknowledgements for his work, including one of the most celebrated awards given in the field of prosthetics, the Brian Blatchford Memorial Prize, for creative design.

#### **Overview of Flex-Foot History**

Flex-Foot Inc. was established in 1982 by Van L. Phillips. Phillips received his diploma in Prosthetics at the Northwestern University Medical School. After graduation, he conducted research in prosthetics at the University of Utah. At the same time, the use of carbon fibers for airplanes was being studied, and it was there that Phillips got the idea of using such fibers for the first product in the Flex-Foot product family.

Two years after Van Phillips established Flex-Foot with three of his friends, the company suffered from lack of funds, and the need for an experienced managing director became apparent. J. Roberts Fosberg, an executive with extensive experience in the health sector, as well as formal education in business administration and medicine, became the director. Phillips' colleagues sold their share in the company, and from then on, it focused on product development and the design of prosthetics.

The company's revenues and market share have grown year by year since its establishment. Since 1984, the annual increase in revenues has been 30% and annual increase in pre-tax profit has been 28%. In 1987, Maynard Carkhuff began working for the company and has been its CEO since 1998.

In April 1998, Flex-Foot acquired Mauch Inc., a Dayton, Ohio, firm established in 1959. The chief products of Mauch Inc. are knee joints. The company's two main product lines are SNS artificial knees and components. Mauch produces medical supplies that are surgically inserted into patients. The Mauch acquisition was a part of Flex-Foot's drive to broaden its product range. For many years, Mauch knee systems have been used concurrently with Flex-Foot products. The trademarks were thus well known, both in their own fields and in the minds of customers.

Today, Flex-Foot is a leader in the design and production of prosthetic devices. The company has a strong position in the market with 14 main production lines and some 29 patents listed in more than 20 countries. Well-designed machinery and equipment support its future growth. The main markets for Flex-Foot products are the United States, Europe, Canada, and Japan. Flex-Foot's objective is to offer its clients "life without limitations," and its primary strength is in knee joints and artificial feet. Through the merger of Flex-Foot/Mauch and Össur, the market will see a company that can offer its clients a more comprehensive solution. Furthermore, the merger provides the Company with enhanced opportunities to expand its operations into other areas of rehabilitation.

### Össur Shareholders

The Company's capital stock at the end of 1999 was ISK 211,937,460, thereof ISK 4,882,500 transferred from the previous year. Bonus shares were issued in the amount of ISK 155,117,500 and new capital was issued in the amount of ISK 51,937,460 on March 23, 1999. Össur Kristinsson was the owner of 45.02%, and the total number of shareholders was 4,635. The ten largest shareholders owned 75.98% in the Company.

Capital stock development has been the following: at a shareholders' meeting held on July 5, 1999, a stock split was approved, and the capital stock after the split amounted to ISK 160 million. At the same time, the Company's Articles of Association were changed to the effect that the Company's Board of Directors was granted authorization to offer new capital up to a nominal value of ISK 25 million. ISK 13,937,460 of this authorization was utilized in late July. The rest will be utilized in support of the Company's personnel policy of attracting and keeping top-quality employees by granting them stock options..

The Board of Directors was also granted authorization for an increase of capital stock of up to ISK 50 million, part of which was used in September 1999 when an offering of the Company's shares took place. The pre-emptive rights of shareholders according to the Company's Articles of Association do not apply to sale of shares decided upon by the Company's Board of Directors on the basis of this authorization. At the Company's General Meeting on March 24, 2000, an authorization for the increase of capital was granted in the amount of ISK 70 million. It was approved to use up to ISK 60 million for this share offering and up to ISK 10 million for stock options for new employees. This capital has not been used to date, but new contracts are in preparation for new employees.

### Overview of Capital

	Capital (ISK)
From previous year	4.882.500 krónur
Issued bonus shares	155.117.500 krónur
New capital	51.937.460 krónur
<hr/>	
Total capital at end of 1999	211.937.460 krónur

The largest shareholders in Össur hf., according to the shareholder register on 23 March 2000, are:

Name	%	Nominal Value
Össur Kristinsson	45.02	95.414.919
Kaupthing Lux	3.86	8.173.303
Bjarni Össurarson Rafnar	3.02	6.392.524
VIK Holding	2.72	5.762.549
Audlind	2.67	5.648.413
Lilja Össurardottir	2.17	4.596.324
KMC (Global Equity Class)	2.09	4.421.026
Havoxturnarfelagid, Fund 1	1.27	2.690.097
Havoxturnarfelagid, Fund 9	1.24	2.631.918
Kristin Rafnar	1.24	2.628.893

The total number of shareholders is 4,829.

Following the successful outcome of the offering, the issued capital of Össur hf. will be ISK 271,937,460. In addition, the Company has an authorization to issue new capital at the nominal value of ISK 33,062,540. Of this amount, ISK 22,267,135 is intended to meet stock option agreements and the remainder, ISK 10,795,405, is intended to be used for the acquisition of other companies if such an opportunity presents itself, or to be sold as may be determined by the Board of Directors.

The pre-emptive rights of shareholders according to the Articles of Association do not apply to capital stock increase according to these authorizations.

**Possible Financial Connections Among Shareholders**

Although there is no knowledge of a shareholders' agreement or any other agreement among shareholders with regard to voting, it is nonetheless clear that certain shareholders in Össur are related by blood or by marriage and could be financially connected. The following is a short list of shareholders who might be connected in one way or another:

Össur Kristinsson is the father of Lilja Össurardóttir and Bjarni Össurarson Rafnar. Kristin Rafnar is Össur Kristinsson's sister-in-law.

Kaupthing Luxembourg S.A. is owned by Kaupthing hf. and Audlind hf. Havoxturnarfelagid, fund 1 and 9, and KMC (Global Equity Class), are mutual funds operated within Kaupthing hf.

Vik Holding is a holding company of which of Jon Sigurdsson, CEO of Össur hf. is the majority shareholder.

### III. Vision

Össur was originally established as a prosthetics facility, but although the operation of the prosthetics facility is now only a small part of the corporate structure, the Company's growth is still based on this technology. The primary objective and role of the Company – the design and production of prosthetic devices – is defined in this light. The managing executives of Össur believe the growth potential in the prosthetics market to be great enough to preclude the need to move into other sectors of the health industry in the immediate future. Some of Össur's competitors have entered into distribution and sales concurrent with their prosthetics services. Össur has decided not to enter these sectors unless they support or are necessary to the Company's basic operations.

Össur has been successful in the design, production, and marketing of prosthetics. It is the Company's objective to foster further growth in this area, both through continued creativity and through the hiring of able employees who are given the opportunity to develop their skills. Össur intends to remain a leader in the prosthetics market and views that market as the core of its operations. As the Company grows even stronger and more knowledgeable, it will look for new ways to utilize its knowledge of health products in related markets.

It is the opinion of Össur's management that the following factors, among others, have laid the groundwork for the Company's success:

- A cohesive group of employees and a management team with fundamental knowledge and experience in this sector of the health industry.
- The Company's reputation for innovation, i.e., breaking new ground with original and revolutionary methods that have gained public acknowledgement.
- Progressive hi-tech products, many of which are used as a basis for comparison with other products in the market.
- Worldwide sales, marketing, and agent system.
- A whole range of products that anticipates impending changes in the healthcare systems of most countries, e.g., increasing demands for independence among amputees and cost restrictions resulting in part from society's demand that the limited funds used for healthcare be distributed for the greater good.

Policy-making for the coming years is predicated on matching the Company's strengths and characteristics to the needs already present in the market, as well as building on information gleaned by Company research. The main components of this policy are:

a) Increased research and development of new products. One of the cornerstones of Össur and its subsidiaries is to develop new products and improve existing ones. Furthermore, emphasis will be placed on new technology that anticipates foreseeable changes in the health systems of various countries in the years ahead. The Company's Development Divisions employ staff with superior knowledge of compound plastic and fiber materials, as well as chemical technology and its use within the industry. The Reinforced Development Division also has the goal of shortening the development time of each product from the idea stage to the marketing stage, and to conduct efficiency studies of the Company's production process.

b) Enhancement of the Company's current market status and expansion into new market areas. The Company's marketing activities are largely based on conducting seminars and otherwise disseminating information in many countries – especially useful for new products and techniques developed by Össur and subsidiaries and thus not widely known in the market. The seminars and information dissemination will increase considerably as other products are developed. Emphasis will be placed on employing professionals to manage this type of sales & marketing. New markets will also be explored.

c) Investment in other companies in this sector of the health industry. One of the Company's most important projects in coming quarters will be the further expansion of its product range in order to gain a larger market share. It will also attempt to make better use of the Company's existing marketing and distribution systems. One way to reach this goal is to acquire related companies possessing products and expertise compatible with Össur's operations. For the following two reasons, the Company believes it is well prepared to act on this policy: 1) There is no competitor presently listed on a stock market. This gives Össur easier access to financing and an unequivocal head start in the event of a takeover or merger. 2) The sector is characterized by many small companies threatened by increasing competition. It is the opinion of Össur management that the sector will experience a considerable number of mergers and takeovers in the near future. The reasons for this opinion include the following:

- Mergers and takeovers are already taking place within prosthetics facilities.
- Companies without comprehensive solutions find it increasingly difficult to do business with growing service units.
- Many small companies find it increasingly difficult to abide by regulations regarding prosthetics, which were classified as medical equipment in 1998, and to meet the costs attendant to such regulations.

Össur's objective is to devote the funds that investors entrust to the Company toward presenting its clients with ways to improve their lives, while offering its employees an exciting and demanding environment where they can grow and prosper with the Company.

## IV. The Prosthetics Industry

Össur operates within the prosthetics sector (orthotics & prosthetics) – a segment of the health-care industry. Included in the prosthetics sector are splints (orthoses) and artificial limbs (protheses).

### **Orthotist**

An orthotist is an expert who provides and designs support and rehabilitation equipment for a patient with disabled limbs or a disabled spine.

### **Prosthetist**

A prosthetist is a specialist who provides patients with prosthetic devices, i.e., artificial limbs for those who have suffered partial or full amputation. A prosthetist also provides training in the proper use of the devices.

Prosthetists are a part of the team that manages rehabilitation in the healthcare system. They make decisions regarding the patient's needs, in collaboration with a physician, a surgeon, a physiotherapist and a social worker. The prosthetic device is designed with the needs of the patient in mind; it is fitted, and the patient is taught how to use it. The physiotherapist then takes over and trains the patient in using the device properly.

The choice of an artificial limb for a patient requires the consideration of many factors other than technique or cost. Research has shown that the comfort of the device and the patient's degree of satisfac-

tion with his/her artificial limb have a profound effect on his/her overall happiness. When an amputation takes place, it causes great emotional pain. Comfortable prosthetics that enable a patient to reclaim most of his/her former mobility have a considerable effect on his/her mental well-being, reducing the possibilities of depression and strengthening his/her personal image. Emotional well-being, in turn, increases the likelihood of recovery.

The work of a specialist in the field of prosthetics centers around using better materials and the latest technology, organizing individual factors and ways to meet the needs of individual patients. The specialist examines what each individual requires, because each patient is unique.

### **The Needs of Amputees**

Amputees are increasingly involved for their own welfare and have begun to work with healthcare professionals in order to improve their quality of life. At present, over 50 groups in the United States share their experience, information, and interest in prostheses and related products. These changes in the health industry, and particularly in prosthetics, have a direct effect upon the work of the prosthetics expert.

A survey made among amputated patients revealed that the average age of those who responded is 51 years. 56% had been wearing an artificial limb for

more than 5 years . The most common operation was an amputation below the knee. Comfort and the functionality of the artificial limb were what users emphasized most. 52% said comfort was most important, while 38% believed functionality was most important. The survey revealed that 67% of amputees use an artificial limb more than nine hours per day. About 57% reported suffering some kind of discomfort from that use. Many complained of having received little or no information regarding amputation. The chief providers of such information are the prosthetist, support groups, and brochures.

Both Össur hf. and Flex-Foot have emphasized the importance of providing their patients with education and information, as can be seen on the websites of both firms: [www.ossur.is](http://www.ossur.is) and [www.flex-foot.com](http://www.flex-foot.com). By supporting athletes and athletic events, the companies have proven pivotal in supporting the improved self-image of amputees.

#### Special Status

The special status of the health sector is complex but is mostly characterized by strict official surveillance, complicated purchasing processes, and limited effects of economic fluctuations on total expenditure.

For years, the prosthetics sector was exempt from many of the laws and regulations that products and services in the health industry must follow.

Development in recent years has, however, tended toward moving the prosthetics sector closer to the general health market. The purchasing process in the health market is complicated, and a purchasing decision depends on the health system of each area. Usually it is not the user himself but his specialist who chooses the proper prosthetic device. This specialist can be a prosthetist, a surgeon, or a physician who specializes in rehabilitation.

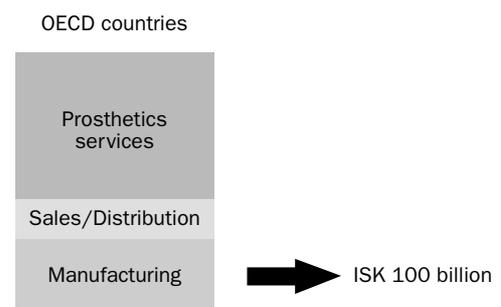
Another important factor is that the patient usually does not pay for the product himself. Instead, a third party – either an insurance company or the social security system – generally bears the cost of the device. With increasing demands for savings in the health system (a widely-discussed issue), the impact of third parties on decision-making could become even greater. Institutions such as hospitals

are developing their purchasing procedures so that decision-making is no longer in the hands of doctors alone. Groups are formed to evaluate which solution is likely to fit each individual. If a product stemming from new technology is to be chosen, its effectiveness must have been tested and researched. It is also necessary to show that its use will result in considerable savings over traditional methods or products.

#### Size

The 1997 turnover for the world's health market is believed to total about USD 1.73 billion. The prosthetics sector's share of this market is believed to be just over USD 4.1 billion. The prosthetics sector can be divided into three fields: a) service to users and the manufacturing of prostheses, b) manufacturing and c) distribution and sales.

An informal estimate values the service sector at about 65 – 70 % of the total turnover, an amount equaling USD 2.2 billion. Therefore, it can be assumed that the market in which Össur operates has a turnover of about USD 1.1 billion per annum.



The health market varies depending on the level of prosperity in given market areas. The largest single market is the United States, where the total turnover is believed to total 50% of the world's combined expenditures. 70% of all health expenditures are generated in the United States, Great Britain, Germany, and Japan. These countries are Össur and Flex-Foot's largest markets.

#### Development

General opinion holds that the growth of the health market will amount to 6 – 8% per annum, which means that it will double in the next 10 years. It is

likely that the prosthetics market will follow this pattern. Össur management believes the Company can grow at a rate of between two and three times market growth in the immediate future without further mergers or takeovers. They believe that the Company could continue this growth in the long run as well. This estimate is based, for example, on the following factors in the Company's environment, all of which appear to be developing in favor of the prosthetics sector:

- **Changed Age Distribution in the West.** The percentage of people aged 65 and older will increase at a rate three times that of younger generations. In the United States, the number of people aged 65 and older will increase from 35 billion to 53 million in the next 20 years, a change of about 51%. Subsequently, the frequency of vascular diseases, diabetes, and arteriosclerosis – diseases that often lead to amputation – will increase considerably. Increased disposable income and greater political influence of this age group as well as demands for enhanced well-being such as the ability to move about and to participate in the employment market will probably lead to greater demand for prosthetic devices.
- **Social Demands.** A constantly increasing number of disabled individuals demand greater independence in order to go about their daily routines without outside help. Surveys show that funds invested in rehabilitation result in lower health-care expenses, mostly because rehabilitation enables people to reclaim their former abilities. Helping people use artificial legs instead of a wheel chair is a good example of rehabilitation.
- **Technical Development.** Extensive development in technology and knowledge of the characteristics of chemicals and chemical compounds have yielded lighter, more advanced and more comfortable prosthetic devices that – despite being more expensive – are ideal for a large group of users. More advanced prosthetic devices allow disabled individuals to more quickly and efficiently achieve increased mobility and joy in their lives.

- **Renewal.** The lifetime of traditional prosthetic devices used by previous generations is three to five years. Present prosthetic equipment is usually more delicate. The demand for precise adaptation to the residual limb causes infinitesimal changes in the size and shape of the residual limb - the normal result of pressure on the limb and changes in weight. This, in turn, can require replacement at intervals of six months and less.
- **Market Niche.** Reorganization of healthcare services has meant that some kinds of healthcare services are employed in outpatient facilities such as nursing homes, daycare facilities, and home nursing. The goal is to lower costs within the health sector, which in turn increases demand for the efficiency of the solutions chosen. This change in structure has broadened the group of specialists who make decisions regarding the choice of prostheses. These specialists are Össur's target group. The intention is to reach this new target group with a different market approach.

In the opinion of Össur's management, this development will be favorable for the Company. Össur is a leader in the development, marketing and sale of products that have already gained ground and are among the products contributing to growth in the prosthetics industry today. New rehabilitation methods and the building of prostheses marketed by Össur also imply a large production increase for prosthetics facilities, as well as considerable savings for insurance companies.

#### **Structure**

The total number of prosthetics specialists in the world is small. Today there are only about 2,600 prosthetics experts in the United States, 700 in Germany, and about 600 in Great-Britain. Prosthetics facilities are often small family-owned companies employing one to two prosthetists along with prosthetics builders and other assistants. This type of facility is on the wane, however, as prosthetics facilities are continually becoming larger. Their owners consequently fewer. Hospitals and health institutions have seen that it is to their advantage to operate prosthetics facilities nearby in order to reach economy of scale and to be able to offer com-

prehensive health services, a factor which is increasingly more important in light of the mergers and acquisitions taking place within the health industry. There are also examples of prosthetics manufacturers acquiring prosthetics facilities in order to gain better access to sales distribution.

A change has occurred in the way that some of Össur's markets function: Physicians such as orthopedic surgeons, vascular surgeons, and rehabilitation specialists are increasingly responsible for the choice of prosthetic devices. Therefore, they assume the responsibility for finding the ideal solution for each individual, and in some cases the prosthetics expert acts only as an advisor and the maker of the prosthetic device.

#### Össur's Market Area

About 70% of the health market's total turnover is said to be in the United States, Germany, Great Britain and Japan. This ratio, in Össur's opinion of representatives, is similar in the prosthetics market. It is estimated that the market share of the Company, after its purchase of Flex-Foot, is between 3 and 5% of the prosthetics manufacturing market.

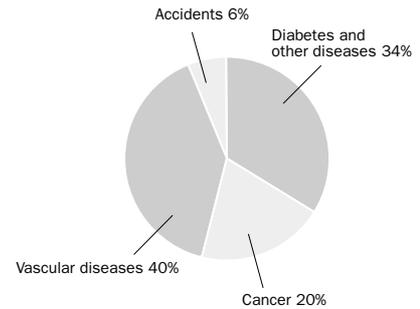
The United States is the single largest market area of Össur and its subsidiaries, but Germany, Great Britain, and Scandinavia are next in line. The table below shows the ratio of individual market areas in the Company's total export, as it was in 1999.

Össur sales to market areas:

Market area	Ratio of total sales
North and South America	52
Europe	45
Australasia	2
Africa	1

Five of the ten largest health markets of OECD countries – France, Spain, Italy, Japan and Brazil – account for only about 6% of the Company's total exports. The Company is actively engaged in reinforcing these markets, and extensive growth is expected in the future.

#### The causes of amputation



6% of all amputations are because of accidents while 74% are because of vascular diseases and diabetes.

#### Causes of Amputation

The most common causes of amputation are prosperity diseases related to aging, e.g., diabetes and vascular diseases. Accidents account for only about 6% of all amputations in developed countries.

Patients who use Flex-Foot products after amputation differ from general users, as the company has previously focused on products for more active users. In a 1997 survey of Flex-Foot customers, the primary reason for the use of artificial limbs was accidents and diabetes followed close behind.

Vascular diseases and cancer are amputation causes for 53% of Flex-Foot's clients. The typical client of Flex-Foot is different from the target group as a whole because the company has, until now, tended to emphasize products with a high degree of functionality; therefore, the clients have been younger than is common among amputees. Flex-Foot has developed various products aimed at older users and intends to market them in coming quarters. The chief causes of amputation are, in part, the Western way of life and the aging population of Western nations.

#### Peripheral Vascular Diseases

Peripheral vascular diseases, PVD, are the single most common causes of amputation. Serious diabetes and heart diseases can cause vascular diseases where the blood flow to the limbs is reduced. This, in turn, can necessitate amputation.

The outcome of the disease varies, depending on which veins are afflicted; but the disease most often appears in the heart, the brain or the legs. Arteriosclerosis forms when arterial walls thicken, leading to impaired blood circulation and a lack of oxygen in relevant areas. Arteriosclerosis can begin to form at the age of 20 and becomes more serious as years go by. Some risk groups even include children who can be overweight, have elevated blood lipid or diabetes. Children's interest in physical activities has diminished, which in turn increases the risk of vascular diseases.

**Diabetes**

According to the American Diabetes Association, there are about 16 million diabetes patients in the United States – a number equivalent to 5.9% of the population. 10.3 million have been diagnosed with the disease, but over 5 million people are not aware that they have it. Each day about 2,200 people – or about 800 thousand people per year – are diagnosed with diabetes. Diabetes is the seventh most common cause of death in the United States and has proven to be a chronic disease that is difficult to cure. Diabetes is divided into two main types: one begins early in life, while the other begins in middle age. About 5 – 10% of patients in the United States – about 900,000 people – carry the first type. It can begin at any age, even in childhood, but the majority of patients are diagnosed when they are teenagers. This type of diabetes is caused by lacerations in the pancreas, an organ that produces insulin. In adult-onset diabetes, however, the pancreas is more or less functioning, but the body's cells have become immune to insulin. Instances of insulin-independent diabetes are on the increase all over the world. This type of diabetes is primarily caused by obesity resulting from poor eating habits, particularly from large amounts of sugar and mono-carbohydrates in the patient's diet – and by lack of physical activity. Each year about 67 thousand amputations are performed in the United States because of diabetes. Diabetics over age 65 are now about 61% of those amputated in the United States.

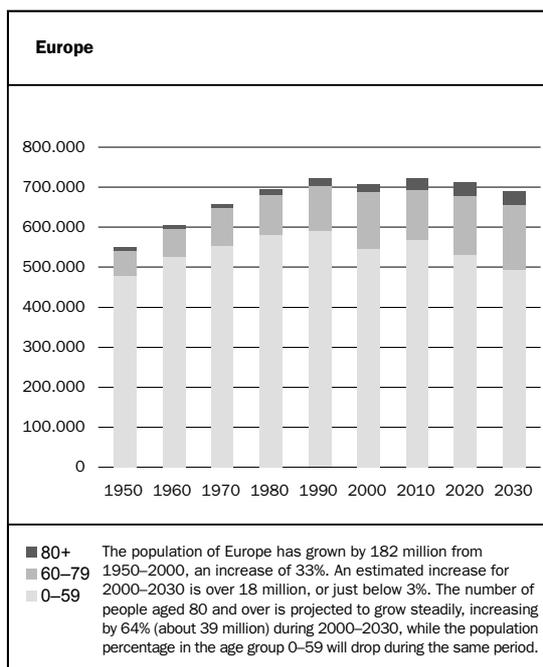
**Heart Disease**

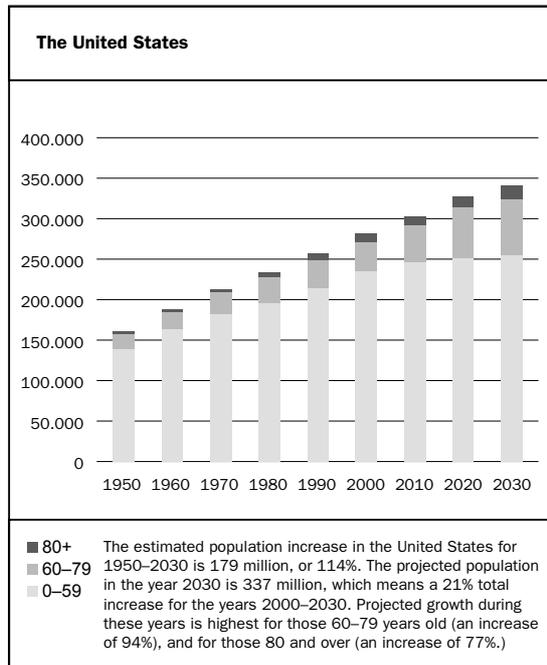
The most dangerous prosperity diseases we live with today are heart diseases. The cause of heart disease is mostly found in people's lifestyles, i.e., lack of exercise, overweight with high blood pressure, too much saturated fat, calories, salt, and smoking. Coronary diseases are one of the most common health problems of the West and appear to be on the rise.

**Changed Age Distribution**

The factor that is assumed to have the most effect on the demand for Össur's products is the changing age distribution of the world's nations, particularly the Western nations. In the world as a whole, it is estimated that the population of the youngest age group will stop increasing around the year 2020 and increases will mostly be in people over age 60.

The products of Össur and Flex-Foot are expensive solutions. So far, mostly prosperous countries – where the nation's aging is already apparent – are able to use them. In coming decades, other nations are expected to join that group.





### Product Development

A traditional artificial leg is comprised of a sock that protects the skin from friction and a hard socket, made from a cast of the residual limb, which is attached to the limb with straps or belts that go around the waist and shoulders. Various components are attached to the socket, to which the front of the leg of wood or plastic is then affixed. The socket was previously made from aluminum, wood or heavy plastic materials, but in recent years the use of various fiber materials has increased dramatically.

Össur introduced a new method to the prosthetics sector with the marketing of the ICEROSS silicon socket, an invention that replaced socks of lamb's wool or cotton and drastically reduced friction and resultant skin problems for the residual limb and socket. The use of this new solution has increased rapidly, and over a dozen companies have now begun producing ICEROSS imitations. Nonetheless it is believed that relatively few amputated individuals in the world today use this new method; thus the growth potential is still great. This solution includes new types of locking devices that have supplanted the traditional strap and belt fixings. Össur is relatively strong in this market, and product development in this field was recently enhanced.

The ICEROSS silicon socket solved two major problems intrinsic to the traditional technique. First, the artificial limb had been attached with straps and was thus badly affixed to the body. The silicon socket, however, creates a suction on the residual limb and is additionally affixed with a lock on the artificial limb – an innovation developed by Össur. In the second place, the residual limb is often sore, but the silicon technique offers more softness and a more favorable weight distribution. Progress in the prosthetics industry has largely been based on chemical technology originating in aerospace and aeronautic science, using various types of light metals and metal compounds such as aluminum, titanium, and magnesium, as well as different types of plastic and fiber composites. In addition, several soft fabrics have revolutionized the production of materials used to link prosthetic devices to the body. Össur has participated actively in this development and is a leader in the use of plastic and carbon fiber composites. The ICEROSS silicon socket and the ICEX fiber socket are products that marked a turning point in serial-produced components for the prosthetics industry.

This new chemical technology has also had dramatic effects on the manufacture of artificial feet. Traditional artificial feet, as stated earlier, are made of wood and plastic and have little functionality. In the late 1980s, Flex-Foot developed the first artificial feet produced from carbon fibers – with or without ankle movement, which makes walking much more normal and less tiring by picking up energy, storing it, and then returning it into the step. Because of the high cost of these new feet compared to traditional ones, potential in this market has increased considerably. Flex-Foot is a leader in the recent technological development in this market. Flex-Foot is not a producer of its own goods and seeks outside sources for production. Össur has extensive knowledge of and experience in the production process, and Össur's managing executives hope that great strides will be made when the two companies join forces.

Because of computer technology, development in the prosthetics industry has progressed at a faster rate than in the healthcare industry as a whole. Equipment for gait analyses has revolutionized the

development of new types of sockets, artificial feet, electro-driven hands, and knees. Flex-Foot's collaboration with the Massachusetts Institute of Technology is, for example, based on the cooperation of scientists from both parties and on access to MIT's hi-tech equipment for the computation and model design of artificial knees and other artificial leg devices.

Scans and CAD/CAM (Computer Aided Design/Computer Aided Manufacturing) enable prosthetics experts to scan a three-dimensional form of the residual limb, which is used to make a cast of the limb in computerized curving machines. The flaw in this technology is that the initial cost is enormous; those who have invested in it are mostly large facilities. Smaller facilities send information in electronic form, sometimes through the Internet, to the prosthetics factories that produce, in one or two days, an artificial leg – which is then sent to the service facility for fitting. The ICEX socket technology developed and marketed by Össur goes, in fact, one step farther than the CAD/CAM technology. The traditional method of making a hard socket is first to make a cast of the residual limb and then to form the socket accordingly. This socket will, of course, never be so perfectly shaped as the limb. The positive outcome of the CAD/CAM technology is mostly the result of a more precise cast of the limb. By using the ICEX technique, however, there is no need to make a cast of the limb, because the socket (which is, in fact, the cast itself) is made directly onto the limb in about 30 minutes. This technique shortens the time used in making a hard socket from 15–20 hours to 2–3 hours. This is a revolutionary innovation that needs time to become recognized. What has mostly prevented the growth of ICEX is the reimbursement system used in many countries, where the prosthetics expert is paid commensurate with the time he spends making the foot. If he changes over to ICEX he will be paid for only 2–3 hours instead of 15–20. In other words, this timesaving method results in a loss of income for him. With increasing financial supervision and insurance companies' requiring the reduction of prosthetics expenses, the ICEX technique is an ideal solution. It has already attracted the attention and recognition of a number of prosthetics experts. With powerful marketing and presentation of the solution to authorities and insurance companies, the ICEX

technology should have considerable growth.

Össur's executives believe, however, that it will take a long time for ICEX to achieve general recognition. The sale of this product is not expected to have any serious effect on the Company's finances in the next two or three years.

### **Competition**

Competition in the prosthetics market is extensive and is characterized by innovation and rapid technological development. Competitiveness is based on factors such as service and education for clients, the design and functionality of the product, accessible use, the influence of prosthetics experts, and the efficiency of the technology.

There are probably over 100 prosthetic production companies in the world, but mergers and takeovers are few in this market. Össur was the first firm to be listed on a regulated securities market. Information regarding competition is thus not easily available. Both Össur and Flex-Foot have, on the other hand, conducted market surveys. Their conclusions have shown that one company, the German entity Otto Bock, is by far the largest. Otto Bock currently has a market share of about 20% and has gained ground in almost all the largest market areas. The second largest competitor is the American company USMC, with less than a quarter of the Otto Bock turnover and with the largest portion of its market in the United States. The third largest company is Blatchford Ltd. in England (an entity roughly the same size as USMC), which dominates its domestic market while maintaining a fair share of the international market. The fourth and fifth largest companies are American – Fillauer Inc. and Flex-Foot – and the sixth largest is Össur hf. When Össur acquired Flex-Foot, Össur became the second largest in the prosthetics market. The ten largest firms in the field have a combined market share of approximately 40%, and the remaining 60% is divided among over 90 companies. This shows that mergers and takeovers are still rare but will undoubtedly increase in the near future. Össur and Flex-Foot's competitors will likely react to this merger that has formed the second largest company in the market.

Price competition has increased in recent years and has become a stronger competitive factor than before. This is particularly true if the product does not carry a known trademark or specialty proven through clinical research to outperform other solutions used by prosthetics experts. Because those who bear the cost of health services have ordered restrictive measures, less expensive solutions weigh heavily in purchasing decisions. Össur's management projects that companies offering comprehensive solutions – and saving the health sector huge sums of money in the rehabilitation process – will come out on top. Össur and Flex-Foot's product

lines place the Company in a very strong position by being able to offer purchasers comprehensive solutions. In addition, Össur, ICEROSS, Flex-Foot, and Mauch are strong trademarks that provide the Company some protection from competition. Össur's competitive status was considerably enhanced when the Company was listed on a regulated stock market. The Company became the only manufacturer in this sector of the prosthetics industry to gain access to capital in the stock market. Therefore, Össur has a chance to maintain its leading position in the expected rush for mergers in the prosthetics market.

## V. Operations

Össur hf. is a production and service company whose driving force has been innovation and marketing. With its purchase of Flex-Foot, the Company has gained an even more powerful product line and has purchased valuable knowledge in the sales and development of prosthetic devices, particularly in artificial feet and knees.

Össur's primary weakness until now has been the lack of its own sales system but such a system is costly to build. A considerable economy of scale can be obtained in having a sale system.

The prosthetics market in Iceland is small, and the marketing aimed at foreign countries during the Company's original years of operation was the prerequisite for its existence today. The organization and structure of Össur is characterized by the necessity for a small production company to build an international sales and marketing system. In such a small but international market, it is important to utilize the opportunities available in the largest markets, i.e., North America and Europe.

Flex-Foot's home market, the United States, is the single largest healthcare market in the world. The country's democratic development is favorable to the prosthetics sector, but what has mostly hindered Flex-Foot has been lack of access to funds. For some time Flex-Foot aimed at a listing on a regu-

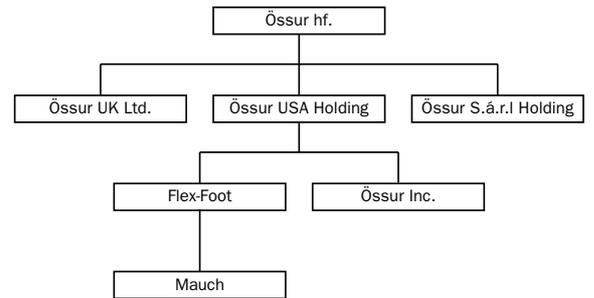
lated stock market, but this idea was abandoned upon the merger with Össur. The intention is that the two firms will operate independently, with unchanged management in the near future. Each will protect its own trademarks, which are among the best known in their specific fields within the prosthetics sector. It is relatively clear, however, that considerable cooperation will be crucial to sales, research, and development work.

### **Össur's Role**

In 1999, a decision was made to review the Company's objectives. As Össur has grown rapidly in recent years, it was clear that the firm's role and quality standards should be reviewed in light of a more varied product range and increased emphasis on service to clients. A new role must also take into account the changes within the health sector and appeal to other target groups. After a survey of changes in the health sector and a thorough review of the Company's fundamental and cultural values, the new role of Össur hf. was defined in this manner: "We help people to realize their full potential." The Company's fundamental values were also defined with the keywords: progress, innovation, caring, and quality. The new objectives were introduced to Company employees to increase synergism and to add focus to the work process.

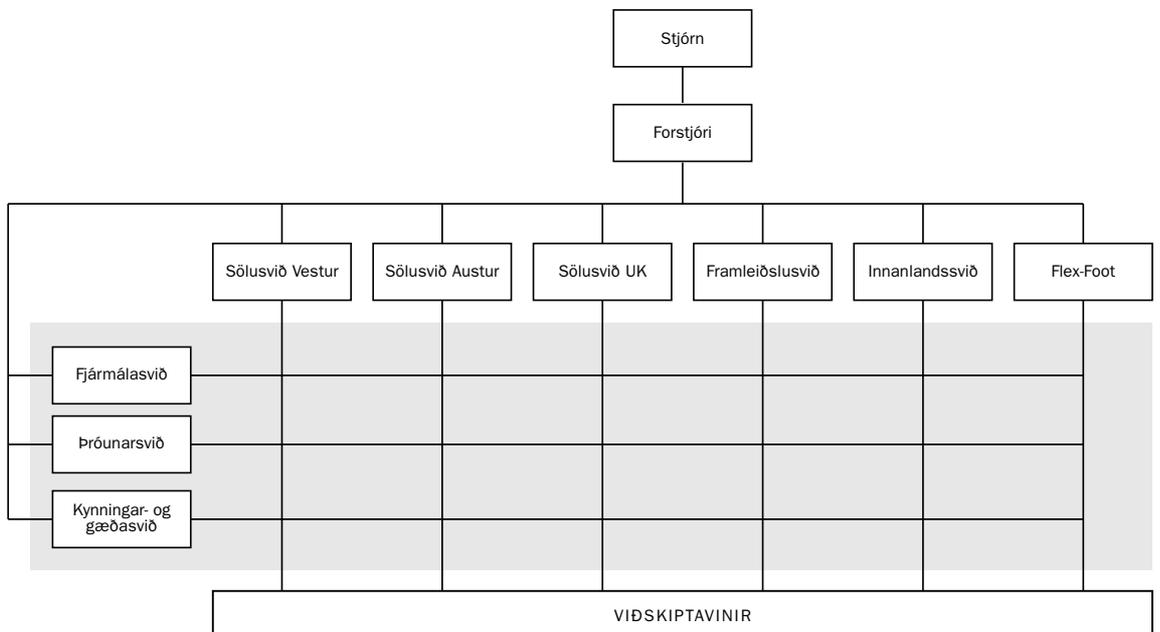
**Organizational Chart**

In the latter part of 1999, executives decided to begin a review of the Company's organization and organizational chart. The primary purpose was to prepare the Company's structure for increased growth as well as to clarify the chart and simplify the message routes. The main changes in the new organizational chart are that the Company's Marketing Division was moved into the Sales Divisions, and marketing will take place from there. In addition, the Company was divided into a cost unit and a profit center. There are three cost units: Finance, Development, and Promotion and Quality. The main objectives of these divisions are to be goal-oriented and to act as a consulting surveillance team. The profit centers are six: Sales East (sales division in Iceland), Sales West (Össur USA), Sales UK (Össur UK), Flex-Foot, Production, and Domestic Field. The main objectives of these fields are sales and service to customers.



**Holdings**

Össur hf. fully owns and operates three subsidiaries: Össur USA Ltd, Össur USA Holding, and Össur S.a.r.l. Holding. Össur S.a.r.l. Holding is not an operating unit but was established as an investment entity following the Company's share offering in September 1999. Össur UK Ltd handles all operations in Great Britain. Össur USA Holding was established in March 2000 to manage the Company's operations in the United States. This company manages Össur USA Inc. and Flex Foot Inc. Flex-Foot's subsidiary, Mauch Inc., is wholly owned by Flex-Foot.



### Profit Bases

The profit bases are the Company's divisions that handle sales to distributors, prosthetics facilities, or directly to clients.

The products of Össur hf. and subsidiaries are sold to 40 countries in North and South America, Africa, Asia, Europe and Australia. The market area is divided into two main sections, East and West. The West section includes the United States and Canada and the East section includes all other countries. Össur USA and Flex-Foot manage the West while the sales division in Iceland handles the East.

**ÖSSUR USA, INC.** Össur USA, Inc., 7100 Columbia Gateway Drive, Columbia, Maryland 21046, is a sales and marketing office for the United States and Canada. Its manager is Siw Schalin. Besides Schalin, the office employs six staff members who handle marketing, communication with distributors, and the packaging and delivery of goods. It also employs one prosthetics expert who manages training and education in the area.

The Company's turnover in 1999 was \$8,719,202 and the profit was \$289,947. Equity at the end of 1999 was \$366,252 and the company's capital stock stands at \$50,000. Össur USA, Inc. is wholly owned by Össur hf.

Considerable changes are expected in the operation of Össur USA Inc. following the acquisition of Flex-Foot. Flex-Foot will, either partly or completely, take over the Össur USA Inc. operation this year.

**FLEX FOOT INC.** Flex-Foot headquarters are in Aliso Viejo, California, just south of Los Angeles, while its subsidiary, Mauch Inc., is located in Dayton, Ohio. The Chief Executive Officer of Flex-Foot is Maynard Carkhuff. Flex-Foot employs 78 people and Mauch employs 57. The company has seven sales representatives who visit clients in the United States and 10 specially-trained customer service representatives for incoming calls from clients. The company's marketing and sales division manages the sales and marketing to 20 distributors who sell the company's products to 41 countries. Mauch employees manage the manufacturing of artificial knees, smaller high-quality metal objects for the prosthetics industry and spinal implants for the orthotic sector.

The Flex-Foot turnover for 1999 was \$27,957,000 and profit before depreciation was \$4,879,000 (EBITDA). Equity at the end of 1999 was \$2,078,000.

**ÖSSUR UK LTD.** Össur UK, Ltd, Synergy House, Manchester Science Park, Guildhall Close, Manchester M15 6SY, is the sales and marketing office for Great Britain and Ireland, and in addition manages distribution directly to prosthetics facilities. Össur UK also operates a prosthetics facility, partly for the testing of new products, and has housing facilities for training prosthetics experts from Europe and Asia. Össur UK employs five people, of whom two are prosthetics experts. Toby Carlsson has been the manager of Össur UK since its establishment in 1995. The British and Irish market is one of the few markets where the company sells directly to prosthetics facilities. This market has grown considerably in the last three years.

The company's turnover for 1999 was £1,195,403 and the profit was £91,929. Equity at the end of the year was below £80,053 and the company's capital stock stands at £1,800. Össur UK Ltd is wholly owned by Össur hf.

**SALES EAST.** The Company's Sales Division is located at its headquarters in Iceland. It manages sales to Africa, South America, Asia, and Europe. The Sales Division employs six people: three area managers and three service representatives. Mr. Eythor Bender is the manager of Sales East.

**DOMESTIC DIVISION.** Össur's domestic division includes a prosthetics facility and a store with mobility aids and rehabilitation equipment for the disabled and the elderly. The head of the domestic division is Mr. Gunnar Skulason. The prosthetics facility has been the core of the Company's operations and produces artificial limbs, splints, back belts and orthoses of various types. There has also been substantial growth in gait analysis and the making of shoe insoles. Össur hf. acquired the Mobility Aids Bank (Hjalpartækjabankinn) in 1995, which was then incorporated into the prosthetics store in January 1998. The store employs specially trained staff, such as nurses and occupational therapists who provide consultancy for individuals regarding various options such as wheelchairs, artificial breasts and elevating equipment, as well as various devices for arthritis patients and the disabled.

**PRODUCTION.** Össur's Production Division employs 45 people and is divided into machinery, polymers, assembly, quality control, and packaging. The Company's production line has broadened and the variety of raw materials used has increased. The most important raw materials are silicone, highly-developed plastic, and carbon fibers. There is extensive processing of plastic compounds and metals such as steel, aluminum, and titanium at the machinery facility. Most of the production is specialized and requires a great deal of expertise.

Production at the machinery facility takes place computerized machines and routers. Production in the polymer division has mostly involved manual work, but using a new technique developed within the company, changes are imminent in order to successfully face market competition. Production methods developed for the production of silicone, polymer and fiber products are the Company's most valuable assets in a competitive market.

The Company's production is based on key materials from a few suppliers who sell high-quality products. Össur chose this route principally because of close relationships that formed with these suppliers when dealing with the development of raw materials specifically suited for Össur's production. The most important and largest suppliers of the company are

located in the United States. The head of the Production Division is Mr. Egill Jonsson.

#### **Cost Units**

Össur's ancillary divisions are Finance, Development, Promotion, and Quality. These divisions are all based at Grjothals 5, Reykjavik, and provide a variety of services to the profit bases.

**DEVELOPMENT DIVISION.** The Development Division, managed by Dr Hilmar Janusson, employs 10 people. Originally, it was only the Company's founder, Össur Kristinsson, who managed all the development work. But as the work scope increased, he has withdrawn from the Company's operations and now works as a consultant for the Development Division. The Division's staff has a wide background, including engineers, turners, chemical engineers, industrial designers, a prosthetics expert and a technical designers. Projects are commonly worked on in groups, for example, research & development projects and building machinery. Expenses for development have increased considerably; between 1996 and 1998 they increased from ISK 37 to 89 million. Development is likely to increase in the future and expenses will be in line with the growth of the Company. The projects of the Development Division are both long-term and short-term, in which experts from the Development and Marketing divisions enter the picture, along with outside parties with which the Company works closely. These outside parties are either suppliers, such as 3M, with which the company has worked closely, or universities and institutions that often manage experiments concerning new ideas or products. Among these are: the V.A. Medical Center, the New York Department of Rehabilitation Medicine, the New York University Medical Center, the University of Jonkoping, the University of Hasleholm-Kristinstad, Strathclyde University, Salford University, Kings College, the University of Iceland, and the National University Hospital of Iceland.

**FINANCE DIVISION.** The Finance Division includes fiscal administration/ accounting, personnel management, asset management, general office management, and a computer and technology section. The head of the finance division is Mr. Arni Alvar Arason.

Planning, monthly settlements, and coordination of operating information from subsidiaries are managed by fiscal administration, while cash and risk management along with long-term financing is managed by the Finance Division. Because of the listing of the company on the stock market, the Finance Division has been expanded to take on increasing investment administration and to maintain the necessary flow of information to the stock market.

**PROMOTION AND QUALITY.** The Promotion and Quality Division includes operation of Össur's quality assurance system, communication with health authorities, CE markings, coordination and surveillance of the Company's image, and communication with both the media and the CEO's office. Promotion and Quality is headed up by Ms Huld Magnúsdóttir.

#### Employees

Össur hf. and its subsidiaries are hi-tech companies and their value creation is mostly based on the staff. The company employs a number of specialists who possess valuable knowledge and experience.

#### Employees of Flex Foot and Mauch

Flex-Foot and Mauch have 135 full-time equivalent positions, of which 78 are with the parent company. The majority of these employees, or about 37%, work in production, while 22% work in sales, marketing and services. In order to enhance relationships with its clients, Flex-Foot employs five full-time and four part-time prosthetics experts who hold lectures to promote the company's products.

#### Key Employees of Flex Foot

The names, ages, and status of the head managers of Flex-Foot and Mauch are:

Name	Age	Status
<del>GARY F. WERTZ</del>	47	<del>Manager of Marketing and Sales</del>
MARK H. EMERY	46	Finance Manager
MAYNARD C. CARKHUFF	54	CEO
RICHARD N. MYERS	39	Production Manager
VAN L. PHILLIPS	46	Founder/Development Manager
WILLIAM L. PHILLIPS	46	Production Manager for Mauch Knee Systems

#### VAN L. PHILLIPS, FOUNDER/DEVELOPMENT MANAGER,

##### 46 YEARS OLD

Van L. Phillips founded Flex-Foot Inc. in 1982 at the age of 28. Phillips lost one leg in an accident at the age of 21 and became interested in prosthetics and related research. He graduated as a Prosthetist from Northwestern University Medical School and then pursued prosthetics research at Utah University, where the idea for the use of carbon fibers for prostheses was born. Phillips was awarded the Brian Blatchford Memorial Prize In 1998 for innovations in prostheses. Phillips has led Flex-Foot development work over past years.

#### MAYNARD C. CARKHUFF, CEO, 54 YEARS OLD

Flex-Foot's CEO is Maynard C. Carkhuff. Carkhuff has 30 years of experience in the healthcare sector. He was the company's Assistant CEO from 1987 to 1998 and its CEO since then. He was graduated with a BS in Marketing from California State University and went on to study at the University of Southern California Graduate School of Business Administration. Carkhuff was the Executive Manager of Denar Corporation before he joined Flex-Foot. Previously he was Marketing Manager at Allergan Pharmaceuticals, and worked in the marketing divisions of Riker Laboratories and Pfizer Laboratories. Carkhuff has taken an active part in social work related to the prosthetics sector in the United States.

#### GARY F. WERTZ, MANAGER OF MARKETING AND SALES,

##### 47 YEARS OLD

Flex-Foot's Manager of Marketing and Sales is Gary F. Wertz. He has a BS in Biology and Chemistry, an MS in Genetics from Western Michigan University, and Executive courses in Marketing from Stanford University Graduate School of Business. Wertz has over 20 years experience in sales and marketing in the healthcare sector. He was self-employed as a consultant for biotech companies before he joined Flex-Foot in 1998. Previously he was District Manager for Allergan and, before that, manager of a sales division at Herbert Laboratories.

#### MARK H. EMERY, FINANCE MANAGER, 46 YEARS OLD

Mark H. Emery has been Flex-Foot's Finance Manager since 1996. Before he began working with Flex-Foot, he was Finance Manager with Glacier

Water Services (1995 -1996) and with SystemeD (1990 -1994). Emery was Senior Manager with Ernst & Young between 1981 and1990. He holds a BA degree from Whittier College.

**RICHARD N. MYERS, PRODUCTION MANAGER, 39 YEARS OLD**

Richard Myers has been Production Manager since 1998. Before he began work with Flex-Foot, he was Factory Manager at Surgical Technologies Inc. From 1995 to 1997 he was Production Manager with Baxter Vascular Systems Division. From 1987 to 1994 he held various positions with Steri-Oss Inc., culminating as a Production Manager. Myers has a BA in Chemistry from Southern California College.

**WILLIAM L. PHILLIPS, PRODUCTION MANAGER FOR MAUCH KNEE SYSTEMS, 46 YEARS OLD**

Phillips is the Production Manager for Mauch Knee Systems. He has over 25 years of administrative experience in various sectors such as the media, prosthetics sector, electronic equipment, and production of medical goods. Between 1990 and 1998 he was the owner and CEO of Mauch Laboratories, a company Flex-Foot took over in 1998. Previously Phillips was President of Enterprise Systems Group, Inc. In 1994 Phillips founded Electrologic of

America, Inc., which specializes in the production of electronic products for the space and medical equipment industries. Phillips has a BA from Memphis State University.

**Other Össur hf. Employees**

At the end of March 2000, Össur hf. in Iceland employed 118 people in 112 full-time equivalent positions. Össur UK employed 7 people and Össur USA Inc. employed 9. The average age of the employees is about 34 years. The division by education and gender of Össur hf. employees in Iceland is as follows:

Education	Men	Women	Total
Higher Education	15	16	31
Further Education	7	1	8
Upper Secondary Education	8	11	19
Vocational Education	13	3	16
Compulsory Education	14	18	32
Other Education	3	7	10
<b>Total</b>	<b>60</b>	<b>56</b>	<b>116</b>

27% of employees have undergone higher education, while 37% have graduated from vocational or other educational institutions.

**Össur's Key Employees**

Below are the names, ages, status, and a short description of Össur hf. Board Members and head management:

Name	Age	Status	Address
<b>Petur Guðmundarson</b>	44	Board Chairman	Reykjabyggð 11 270 Mosfellsbæ
<b>Össur Kristinsson</b>	55	Founder/Board Member	Sæbólsbraut 42 200 Kópavogi
<b>Thorkell Sigurlaugsson</b>	46	Board Member	Tjarnarmýri 6 170 Seltjarnarnesi
<b>Gunnar Stefansson</b>	44	Board Member	Sæbólsbraut 33 200 Kópavogi
<b>Kristjan T. Ragnarsson</b>	55	Board Member	15 South Drive Larchmont, NY 10538
<b>Sigurbjorn Thorkelsson</b>	33	Board Member	129 West 77Th Street, Apt.2 10024 New York, Ny
<b>Jon Sigurdsson</b>	43	CEO	Klapparstíg 35 101 Reykjavík
<b>Arni Alvar Arason</b>	35	Head of Finance Division	Hringbraut 47 107 Reykjavík
<b>Huld Magnúsdóttir</b>	32	Head of Promotion and Quality	Tómasarhaga 27 107 Reykjavík
<b>Egill Jonsson</b>	42	Head of Production	Hrauntungu 28 220 Hafnarfirði
<b>Hilmar B. Janusson</b>	38	Head of Development	Valhúsabraut 33 170 Seltjarnarnesi
<b>Eythor Bender</b>	34	Head of Sales East	Bollagörðum 81 111 Reykjavík
<b>Gunnar Skulason</b>	33	Head of Domestic Division	Kvisthaga 4 107 Reykjavík
<b>Siw Schalin</b>	37	Head of Sales West	13091 Williamsfield Drive Ellicott City, 21042 Maryland
<b>Toby Carlsson</b>	38	Head of Össur UK Ltd	100 Longhurst Lane Mellor, Cheshire SK65PG, UK

Most of those who fill the present management group have worked with the Company since 1996. In the past two years the Company has been greatly expanded to take on new projects in marketing, sales and production. The scope of the head management is not estimated to change in the near future despite increasing administration and turnover.

Össur hf. is a hi-tech company where extremely valuable knowledge of the prosthetics market has been created. Great emphasis is put on employees' continued education, whether within the specialty of each member or in the field of prosthetics as a whole.

Last year remuneration for the Board amounted to a little less than ISK 2,150,000 while wages to key employees in Iceland were ISK 17,870,628, including benefits.

#### Key Employees

Below are the names, ages, status and a short description of Össur Board Members and head management:

**GUNNAR STEFANSSON** has been a Board Member for the Company since 1993. He is Assistant CEO for the Marine Research Institute. He has also worked for the International Marine Research Commission and for the University of Iceland. Stefansson has a PhD in Statistics from Ohio State University in Columbus.

**KRISTJAN RAGNARSSON** became a member of the Össur Board in 1999. Ragnarsson worked in the United States, from 1986 as the Head of Rehabilitation at Mount Sinai hospital in New York and from 1997 as Senior Vice President at the same hospital. Ragnarsson was graduated as a Doctor in Medicine from the University of Iceland in 1969 and a Specialist in Rehabilitation from a US institution in 1976.

**PETUR GUDMUNDARSON** has been Össur's Chairman of Board since 1995. Gudmundarson is the co-owner of Logos solicitors and has been a Supreme Court lawyer since 1986. He is a Board Member for Globus Velaver hf. Gudmundarson received his law degree from the University of Iceland.

**SIGURBJORN THORKELSSON** became a Board Member for Össur in 1999. He has been General Manager with Lehman Brothers investment bank in New York since 1998. Thorkelsson graduated from the University of Iceland as a Mechanical Engineer in 1990 and a completed his Master's degree in Administrative Engineering and Finance at Stanford University in 1992.

**THORKELL SIGURLAUGSSON** has been a Board Member for Össur since 1997. He is the Executive Officer of Development at Eimskip hf. Mr. Sigurlaugsson is Chairman of the Board of several Icelandic companies as well as Vice-Chair of the Board of the Iceland Stock Exchange. Sigurlaugsson is a graduate in Business Administration from the University of Iceland.

**ÖSSUR KRISTINSSON** is the Founder of Össur. He has been on the Company's Board since 1971 and was its Executive Officer from 1971 to 1989. Mr. Kristinsson studied prosthetics in Sweden and was granted a license as a prosthetist from the Swedish Board of Certification for Prosthetics and Orthotics in 1971.

**ARNI ALVAR ARASON**, Head of Finance, has been with the company since 1996. He was the Company's Marketing Manager from 1997 to 1999 and its Product Manager from 1996 to 1997. From 1994 to 1996, he was a marketing manager at Folda hf., while between 1992 and 1994 he was a sales and distribution manager with Christoph Fritzsch GmbH in Germany. Mr. Arason graduated from the University of Trier in Germany with a degree in Microeconomics.

**EGILL JONSSON**, Head of Production, has been with the Company since 1996. He was project manager with an engineering office in Iceland from 1985 to 1996. Mr. Jonsson is a graduate in Mechanical Engineering from the University of Iceland and received his Master's degree in mechanical engineering from the Technical School in Copenhagen.

**EYTHOR BENDER**, Head of Sales East, has been with the Company since 1995. He was the Company's Marketing Manager between 1995 and 1997. Before Mr. Bender joined Össur, he worked at the

Hewlett Packard European Marketing Center in Germany from 1993 to 1995 - and as Marketing Consultant with Hewlett Packard Medical Division Europe (also in Germany) from 1989 to 1993. Mr. Bender has a degree in Microeconomics from the University of Tubingen in Germany.

**GUNNAR SKULASON**, Head of the Domestic Division, has been with the Company since 1992. Skulason began work with Össur hf. as Office Manager, then became Finance Manager from 1994 to 1996 with the subsidiary Össur USA, Inc., and later became Finance Manager for Össur hf. from 1996 to 1999. Mr. Skulason is a graduate in Business Administration from the University of Iceland.

**HILMAR BRAGI JANUSSON**, Head of Development, has been with the Company since 1993. He did research with the Technological Institute of Iceland from 1987 to 1988. Janusson is also a Board Member of other Icelandic companies. Mr. Janusson has a BS in chemistry and engineering from Leeds University in England.

**HULD MAGNUSDOTTIR**, Head of Promotion and Quality, has been with the Company since 1993 and was previously a sales and marketing representative with the Reykjavik Milk Distribution Center. Ms Magnusdottir has a BA in International Communications from Sussex University in England.

**JON SIGURDSSON** has been the Company's CEO since 1996. Sigurdsson was Cultural Attaché of Iceland's Export Council in New York between 1992 and 1996, Head of Finance of Alafoss hf. from 1989 to 1992, Head of the Foreign Division of Eimskip hf. from 1986 to 1989, and Head of the Development Division of Bang & Olufsen AS in Denmark between 1982 and 1984. He is a Board Member of Iceland's Export Council, the Research Commission of the University of Iceland, and Sjoklaedagerdin hf. Mr. Sigurdsson has a BS in Administrative Technical Engineering from the Technical School in Odense in Denmark and a Master's degree in Business Administration from the United States International University in San Diego.

**SIW SCHALIN**, Head of Sales West, has been with the company since 1996. She was Marketing Manager for Iceland's Export Council from 1992 to 1996 and Sales Manager for Alafoss from 1989 to 1992. Ms Schalin has a Master's degree in Economics from the Swedish School of Economics and Business Administration in Finland and a Master's degree in Business Administration from the University of Western Ontario in Canada.

**TOBY CARLSSON**, has headed Össur UK from 1995. He joined the Company in 1984 and worked as a prosthetist with the domestic division from 1987 to 1989. He worked for the British prosthetics company LIC CARE Ltd from 1989 to 1995 as head of a prosthetics facility. Mr. Carlsson received a license as a Prosthetist in 1986 from Halshogskolan in Jonkoping, Sweden.

**Obligations**

The Company has not granted loans or underwritten any obligations on behalf of the Company Board or the CEO.

Remunerations to the Össur hf. Board during 1999 amounted to ISK 17,870,628. No benefits, loans, or guarantees have been granted to these parties.

According to the share registry on March 24, 2000, the board and key managers owned shares to the nominal amount of ISK 107,255,621. The board has ISK 22,267,135 to meet employee options.

Already, options have been made with employees to a nominal value of ISK 11,140,079, as well as a share option with Kaupthing hf., which was listed in the offering and listing prospects in September. The Össur hf. share in this agreement has a nominal value of ISK 1.9 million if it is utilized.

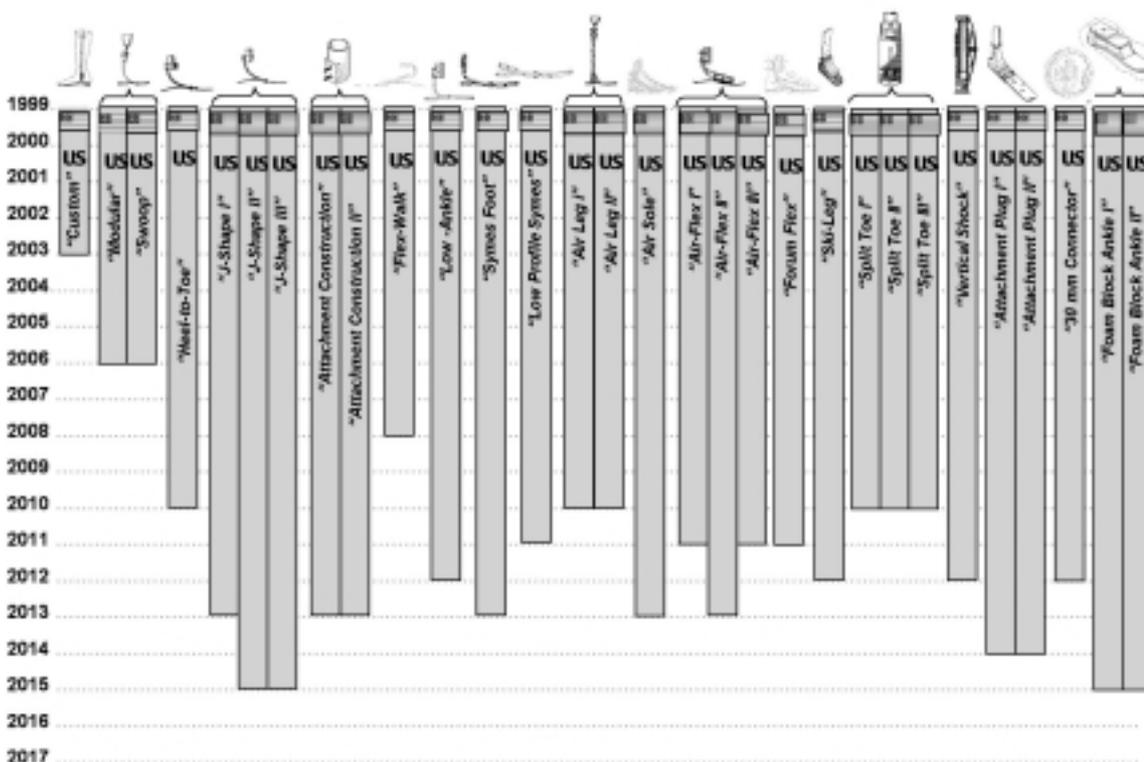
**Patents**

Össur hf. and Flex-Foot Inc. own a number of patents covering individual technical items, implementation and techniques regarding company products. Furthermore, the companies are in the process of applying for patents for new products and for products and equipment in development that will facilitate the further protection of property right through patents in the future. The Company also has the right to use patents held by outside parties in implementing its own products.

The Company also depends on technical expertise that is not patented, as well as trade secrets and production processes, which the company protects through confidential agreements and in other similar manners.

The Company's policy is to protect property rights through patents, where possible, in the most important marketing areas and to protect property rights with confidential agreements where patent protection is not possible.

**Flex-Foot's patents registered í the US**





### **Flex-Foot Patents in the United States**

#### **Flex-Foot Patents**

Flex-Foot has 29 patents, owned by its founder Van L. Philips, and registered in 20 countries. Their validity varies in length but the first one expires in 2003.

#### **Development Cooperation**

Flex-Foot has been cooperating with various institutions and universities for research and development work. The focus of the research is with MIT on the development of artificial feet, based on artificial intelligence. This relationship began in 1997.

#### **Trademarks**

Össur and Flex-Foot products are marketed under various trademarks and the Company has registered well over a dozen trademarks in its main market areas in the United States, Europe and Japan. The best-known trademarks listed are ICEROSS, ICEX, MASTERSTEP, ÖSSUR FLEX-FOOT, SURE FLEX, FLEX WALK, VARIFLEX, and MAUCH. The Company policy is to build on strong and well-known trademarks.

#### **Distribution System**

The Company operates sales divisions that handle the sales and marketing of products to about 25 distributors in over 40 countries. In North America there are currently five distributors of Össur products, while the sales system of Flex-Foot handles the sale of its own production directly to prosthetics facilities. Additionally, Flex-Foot has begun a sales structure system in both Britain and Europe, the latter based in Eindhoven in the Netherlands.

#### **Quality System**

The Company's quality system is partly based on internal control of production and quality of the Company's products, but it also has to comply with official laws and regulations. Laws and regulations figure prominently in the external environment of Össur hf. and its subsidiaries because the European Economic Area issued an ordinance in 1998 on medical equipment. With its enforcement, prosthetic devices were classified as medical equipment, which makes all quality demands much stricter. These laws are better known as CE markings on goods and packaging. American laws from 1996 cover the prosthetics market in the United States. The supervising authority for these laws is the FDA (U.S. Food and Drug Administration). Products falling under this regulation must be approved by the FDA before they are marketed in the United States. Otherwise, the ordinances are similar and cover the main items in the production and marketing of goods within the United States and the European Economic Area. The ordinances are mostly based on the quality standard ISO 9001; Össur hf., Flex-Foot and Mauch have a quality standard system based on ISO 9001.

The use of standards and regulations has increased rapidly in recent years within the prosthetics industry. Össur believes that the Company is well prepared to take on these changes with the use of a quality assurance system.

A producer's responsibility for its own production is extensive in the healthcare market, and producers try to reduce potential risk from the use of their products. Surveillance is strict in both production and testing of new products. Random samples from production are used in accordance with ISO 9001 for quality assurance purposes and to assure clients, authorities, and insurance companies of the quality of the company's production. Össur has formed a work procedure regarding returned goods and complaints, as well as the recall of goods in case of faulty production. The ability to trace the Company's production, from the receipt of raw material to the user of the product, is being perfected to facilitate such recalls. The Company is liable for accidents caused by faulty production as well as for the costs incurred if a product is recalled.

## VI. Products

### The Össur Solution

The Company's products are medical devices intended for prosthetics experts and prosthetics users. The concept "The Össur Solution" stands for the Company's product policy that provides clients with a comprehensive solution and maintains powerful product development – a step ahead of the changes that will occur in the healthcare systems of the Company's major markets. Össur hf. defines itself as a leader in the field of innovation, and products have often brought new dimensions into the prosthetics sector. Prosthetics experts, prosthetics users and healthcare institutions in the field of prosthetics services have enjoyed the benefits of these innovations.

### Active Rehabilitation

Products in the field of active rehabilitation are designed to increase mobility and comfort, and, in turn, improve the lifestyle of the prosthetics user.

### Attachment Liners

When the ICEROSS socket was marketed in 1986, a concept was being marketed at the same time based on the theory of hydrodynamics. The marketing of ICEROSS brought a new dimension into the prosthetics industry and it improved the life of thousands of prosthetics users worldwide. ICEROSS is a comfortable and solid link between an artificial leg and the stump. ICEROSS is made from silicone and polymer materials that are produced under the

### Virk endurhæfing – vörur sem auka hreyfigetu

Tengihulsur	Iceross <sup>®</sup> , Iceross Comfort <sup>™</sup> , Dermo <sup>™</sup>
Hnéhlífar	Iceflex <sup>™</sup>
Vörur til bólstrunar	DistalCups <sup>™</sup> , Iceross <sup>®</sup> Pads
Gerviökklar	Masterstep <sup>®</sup>
Læsingar- og tengistykki	Lanyard Kit <sup>™</sup> , ICEX LOCK <sup>™</sup> , ICEX Offset <sup>™</sup> , Icelock <sup>™</sup>
Stoðvörur	Iceross <sup>®</sup> Clean and Simple <sup>™</sup> , ICEX <sup>®</sup> Socks, Iceross <sup>®</sup> Sheath

### Bætt framleiðni – vörur sem hagræða vinnuferlum

Hulsutækni	ICEX <sup>®</sup>
Afsteyputæki	IceCast <sup>®</sup>
Verkfæri	Iceross <sup>®</sup> CurveMaster <sup>™</sup>

brand name of SENSIL. SENSIL has proven its abilities to support loose flesh, relieve pressure, and act as a skin protector. It is also a particularly durable material.

**Attachment Sleeves.** ICEFLEX is a product that was marketed this spring and brought a new dimension to the sleeve technique. ICEFLEX is either used as an added fixing or as the only fixing between an artificial leg and the stump. The inner layer of ICEFLEX is made from SENSIL silicon and the outer layer is made from Wearforce material from DuPont. The innovation included in ICEFLEX is mostly in the durability compared to other sleeves on the market, as well as the performance that the competitive products do not have.

**Pressure Relievers.** Össur's products intended for reinforcement are also made from SENSIL silicon, and are used with ICEROSS as an extra layer where deep scars exist and where the flesh has been reduced. SENSIL gives softness and evenly distributes pressure over sensitive areas. Its adhesiveness to the skin also protects it from further reduction because of pressure.

The main products in this class are DISTAL CUP and ICEROSS Pads. DISTAL CUP are short stump-end sockets that thin out to the outer edges. Their role is to increase the filling of stumps that have little flesh on the end in order to be able to use standard sizes of ICEROSS.

Products such as these have an important role in making as many clients as possible able to use standard sizes of ICEROSS, instead of specially-designed sockets that are both expensive and time-consuming to make.

Development will continue in this product class as well as others, and new products will be added.

**Artificial Feet.** The patented artificial ankle, MASTERSTEP, enables amputated individuals to achieve an almost normal way of walking, to change shoes, and to fix the weight and activity level without having to change the ankle. Normal walking is achieved because the ankle is made from carbon fiber spring that transfers the energy formed when the heel hits

the ground into the toe, and thus helps the individual to go through the step.

Flex-Foot provides an extensive product line of artificial feet that are further discussed in a special chapter.

**Locks and Components.** Up until now, Össur hf. has offered a rather small selection of locks and components. These components are used to lock ICEROSS to the hard socket and to connect the hard socket to the artificial feet. Work on considerably increasing this selection has already begun and is in line with Össur's policy of offering its clients comprehensive solutions in the field of prosthetic devices. Great emphasis will be put on improving the current system as well as on bringing in systems that will increase the comfort of the user and the work of the prosthetics expert. With Össur hf.'s acquisition of Flex-Foot, the Company has added a new product line of artificial knees, as well as several components that it could not offer before.

**Suppliers.** Supply products are products such as the Company's cosmetic line, ICEROSS Clean and Simple, stump socks, ICEROSS Socks (used for building volume when the stump reduces), and ICEX Sheath (that enables the stump to slide into the hard socket and prevent turning), along with various fixing, and extra and spare parts intended for various product groups.

Supply products are important in maximizing the usability of the current products. The increasing number of suppliers for different product groups is inevitable and enlargement of the product line is to be expected in different fields in the near future.

### Flex-Foot Inc. Products

Flex-Foot's products are all made for improving the life of the prosthetics user and fall under Össur's line of products for "active rehabilitation". The product line is based on various types of carbon fiber-enhanced artificial feet, but various other products are also produced that are used to increase mobility and to improve the quality of life of the prosthetics user. It is the company's objective to be always in the lead in the design, production, and sale of prosthetics goods. The company's products are known for their quality and good characteristics and are used within the prosthetics sector as a benchmark for the characteristics that such products should have.



### Division into Product Lines

The largest part of Flex-Foot's production is manufacturing various types of artificial ankles, but the company also produces many types of artificial knees as well as shock absorbers for artificial legs. The production can be divided into the following three product lines:

#### I. Artificial Feet

RE-FLEX VSP®  
 Modular III™  
 VARI-FLEX®  
 FLEXWALK®  
 ALLURION®  
 Low Profile Symes  
 SUREFLEX®  
 K2 Sensation™

#### II. Knee products

MAUCH® SNS, S-Type og Microlite-  
 Hydraulic system for Artificial knee  
 MAUCH® Gaitmaster-knee

#### III. Shock Absorbers and Components

ICON® schock absorber for artificial feet



### Artificial Feet

Flex-Foot is without doubt best known for its production of artificial feet. Most of the feet are produced from carbon fiber-enhanced artificial materials because carbon fibers are more efficient than any other material at utilizing the energy that the prosthetics user puts into walking on an artificial leg. The feet have various characteristics and are able to fit variously active users, as well as being specialized to different stump kinds. What sets apart Flex-Foot's artificial ankles is twofold: the materials used and the characteristic J shape of the ankles. This design enables users to achieve better and easier movements than with any other ankles on the market. The main types of Flex-Foot's artificial ankles are:

#### I. Artificial Feet

Flex-Foot is without doubt best known for its production of artificial feet. Most of the feet are produced from carbon fiber reinforced materials. The Advanced carbon fiber composite have optimized energy return properties enabling the prosthetic user to fully utilize the energy that is put into walking on an the artificial leg. The feet have different characteristics and are able to fit users of various activity, as well as to accommodate different amputational levels . Flexfoot differentiation is twofold: the materials used and the characteristic J shape of the ankles. This design enables users to achieve better and easier movements than with any other ankles on the market.

The main types of Flex-Foot's artificial ankles are:

**RE-FLEX VSP®.** This ankle was the first to include a shock absorber, Important for active users since higher activity results in high loading of the limb. Along with the energy returning carbon fiber composite spring produces a product that both reduces the difficult impact of high activity as well as giving a high yield of the energy the user has available for movement. This combination of unique design and function provides ultimate comfort during different activity.

**Modular III™.** The original ankle both light and durable. For the group user this design is aimed at, the optimized energy return of this ankle has not been matched by anyone else. Further, the ankle features minimum weight for high activity users

**VARI-FLEX®.** Aimed at user that have a trans femoral amputation the Vari-flex is a good choice. It has similar energy return as the Modular III and a simple connection mechanism fit for trans femoral prosthesis.

**FLEXWALK®.** This ankle is for medium and low activity users. It is suitable for users with long residual limb and others where because of length, it is difficult to accommodate ankles of the energy returning nature.

**Low Profile Symes.** This ankle is for Symes patients. The Symes residual limb require special adaptors to make the most of the very little space for the prosthetic ankle. Yet, this ankle carries the good properties associated with the Flexfoot ankles.

**SUREFLEX®.** Aimed at low activity users this ankle is one of the most popular products of the Flexfoot family. The success is based on the economic value of the well designed ankle made out of the advanced carbon composite material.

**K2 Sensation™.** The latest addition to the Flexfoot line of products is aimed at the elderly users with less requirements but need more economic solution (it is the least expensive foot) and features stability and good gait

#### II. Knee products

FLEXFOOT INC. manufactures knees under the MAUCH® trademark.

**MAUCH® Gaitmaster knees.** Depending on the user conditions different solutions are selected. Among the types of knees are the Gaitmaster Slimline which is the lightest knee offered from the company. Furthermore, there is the Gaitmaster Low Profile which as the name indicates has unique build height a feature valued by prosthetist and user alike since it enables solutions not showing a different length of stump in the users gait or cosmetically.

**MAUCH® SNS and Microlite hydraulic systems.** Along with the Knee product different hydraulic systems are used to meet the user's activity and need. The systems have different movement and control

options. The main products are the MMAUCH SNS, which makes it possible to adjust the performance of the knee at during the gait. Another system is the MAUCH S-type that has reduced control options and the MAUCH Microlite which merits are the unusually light weight compare to other system on the market.

### III. Shock absorbers

**The ICON®** shock absorber belongs to the Flexfoot line of products. It can be used with most Flexfoot ankles or together with ankles from other manufacturer. The main features include high energy return, minimum weight and maintenance free durability. The shock absorbers are designed for users of medium to low activity and relief impact load from the ground for the patient.

Products enhancing clinical productivity and increase activity

Össur products that are designed to increasing productivity and to lower running cost of clinics are aimed at medical doctors prosthetists and other health care professionals for them to offer service which optimizes the use of the prosthesis improves the user activity and making the clinic more productive. Furthermore, the product group fits the current trend all health systems are subjected to i.e. cost reduction, cost control and accountability

**Socket technology.** The award winning ICEX® technique was launched in the year 1996 and is an example of a revolutionary product in the field of

prosthetics. It was designed with the interests of the prosthetists, users and health authorities in mind. It is an effective and attractive technique to make the hard socket directly on to the residual limb in stead of the conventional multi-step plaster casting technique. It combines casting, socket fabrication and fitting into a one step that takes 2–3 hours from the 15–20 hours minimum needed for traditional methods. As one of the company's most interesting product it offers various possibilities in development and sales and marketing. First, The ICEX® was simple but soon new connections and ways to connect with other system have emerged and further adaptations are planned making it more attractive to all patients of different amputation levels and to all clinics. The aim is to make this a standard and preferred method in prosthetic service.

**Casting equipment.** ICECAST® is a pressurized casting apparatus for convenient conforming both the water activated ICEX® to the limb, or plaster of pairs if only the mold of the limb is required. The patented apparatus consists of a silicone bladder applied to the patient stump pressurized to a predetermined and safe pressure.

**Tools.** Prosthetists often need to cut and shape the liner before it is worn by the user. This can be done with knife or scissors. However, unless very carefully done the cutting leaves a sharp edge that can cause skin breakdown at the edge of the liner. The Iceross CurveMaster designed at Össur hf is a knife that cuts easily through the various liner material leaving a round edge that is agreeable to the skin.



## VII. Employee Policy

Össur hf. and its subsidiaries are hi-tech companies and their value creation is mostly based on the staff.

The Company employs numerous specialists who have acquired a great deal of experience and knowledge. This experience is very important to the Company and is a prerequisite for continued growth and prosperity. The Company's production does not require a large workforce but because the product is delicate and delicate materials are used, it takes a long time to train new staff.

Össur's policy is to pay competitive wages and to allow the employees to participate in the Company's success. With this policy as a guiding light, all employees are provided with the opportunity to buy shares in the Company and key managers will be offered the choice of buying options. This way, Össur's managers feel that they can better combine the interests of staff and the Company itself and thus hold on to good employees.

### **Buying Options**

The Company has signed buying options with key employees. The agreements are for either three or five years and are valid if the following conditions are fulfilled:

- The performance of the Company's shares has been better than the performance of the Main List Index of the ISE, whether compared to the previous year or since the Company was listed on the ISE.
- The price is higher than in the general offering to the public.
- The employee is still employed with Össur hf.





## VIII. Operating Information for Össur

**Income statement for 1999**

	Note	Consolidated statement			Parent company		
		1999	1998	1997	1999	1998	1997
<b>Operating revenues</b>							
Net sales	23	1.298.676.652	1.027.144.653	779.868.190	1.081.647.258	818.566.309	506.230.579
Other income		4.128.785	6.383.520	3.616.887	4.044.250	35.196.316	88.917.705
<b>Operating revenues</b>		<b>1.302.805.437</b>	<b>1.033.528.173</b>	<b>783.485.077</b>	<b>1.085.691.508</b>	<b>853.762.625</b>	<b>595.148.284</b>
<b>Operating expenses</b>							
Cost of materials used		232.783.086	219.605.468	213.969.896	239.047.078	227.213.070	179.579.505
Salaries and related expenses	25	344.744.104	308.834.362	237.376.427	281.383.312	230.474.066	174.095.639
Research and development costs		88.513.478	49.158.591	52.539.393	90.707.309	54.925.963	52.539.393
Other operating expenses		398.810.029	276.123.792	215.964.495	278.340.132	183.697.549	142.437.574
Depreciation	4	28.605.554	27.899.770	24.100.173	22.976.771	21.549.765	17.373.622
<b>Operating expenses</b>		<b>1.093.456.251</b>	<b>881.621.983</b>	<b>743.950.384</b>	<b>912.454.602</b>	<b>717.860.413</b>	<b>566.025.733</b>
<b>Operating profit</b>		<b>209.349.186</b>	<b>151.906.190</b>	<b>39.534.693</b>	<b>173.236.905</b>	<b>135.902.212</b>	<b>29.122.551</b>
<b>Net interest</b>							
Interest income (expenses)	24	6.689.912	-23.028.571	-8.571.985	7.706.349	-22.121.965	-8.068.780
<b>Income before taxes</b>		<b>216.039.098</b>	<b>128.877.619</b>	<b>30962708</b>	<b>180.943.255</b>	<b>113.780.247</b>	<b>21.053.771</b>
<b>Taxes</b>							
Income tax	17	-73.841.819	-38.055.575	-12.368.873	-59.339.780	-37.776.945	-7.349.021
Net worth tax		-2.452.772	-2.476.070	-1.023.815	-2.452.772	-2.471.162	-1.023.815
<b>Net income before minority interests/subsidiaries</b>		<b>139.744.507</b>	<b>88.345.974</b>	<b>17.570.020</b>	<b>119.150.703</b>	<b>73.532.140</b>	<b>12.680.935</b>
<b>Minority interests and subsidiaries</b>							
Intercompany investment income	6	0	0	0	20.273.109	13.665.307	3.952.244
Minority interest in net income	2	-320.695	-1.148.529	-936.841	0	0	0
<b>Net income before extraordinary items</b>		<b>139.423.812</b>	<b>87.197.445</b>	<b>16.633.179</b>	<b>139.423.812</b>	<b>87.197.447</b>	<b>16.633.179</b>
<b>Extraordinary expenses</b>							
Discontinued operations		0	-8.084.073	-5.299.660	0	-8.084.073	-5.299.660
<b>Net income for the year</b>		<b>139.423.812</b>	<b>79.113.372</b>	<b>11.333.519</b>	<b>139.423.812</b>	<b>79.113.374</b>	<b>11.333.519</b>

### Income Statement 1999

Össur's revenue last year amounted to ISK 1,303 million, an increase of 26% from the previous year. Operating expenses amounted to ISK 1,065 million and were up by 24.7%. Operating revenue or EBITDA, which is the figure the company's management values the most, was ISK 238 million, an increase of 32.3% from the previous year. EBITDA is 18.3% of the company's turnover as opposed to 17.4% last year.

#### Revenue Divided by Market Sections:

USA	40%
Europe (not including Iceland)	42%
Iceland and other countries	18%

Included in operating expenses is ISK 88.5 million used in Research and Development, which has increased by 80% from last year. As a part of the Company's turnover, the ratio amounts to 6.8%. Research and Development expenses are 10% higher than Össur's management expected. This is, however considered, a positive deviation because the Company is working on very exciting projects. In companies such as Össur and Flex-Foot Inc., the problem is not deciding how much to spend on Research and Development but rather how to allocate funds and employees to projects with the greatest profit potential.

Össur's management is optimistic about the research that is currently underway within the Company.

Materials costs amounted to ISK 233 million, or 17.9% of the company's turnover, a decrease of 3.3% from 1998.

Salaries, wages, and related expenses amounted to ISK 345 million in 1999. Even though these expenses increased by 11.6% from the previous year, as a proportion of turnover they decreased by 3.4%. In addition, salaries and wages in the amount of ISK 45 million were included in Research and Development.

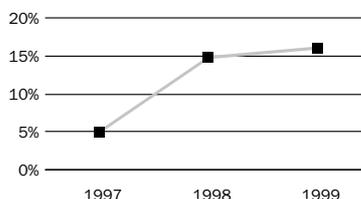
In the year 1999, other expenses amounted to ISK 399 million, an increase of 44%. The increase was mostly in sales and marketing. The cost of the company's capital stock offering last year is included in this item. Össur management sees this cost as an investment in accessing the stock market. This year more expense will be incurred because of the acquisition of Flex-Foot. Should Össur acquire other companies, these expenses could increase.

Last year, depreciation amounted to ISK 28.6 million, and earnings before financial items totaled ISK 209.4 million, an increase of 37.8% from the previous year. Össur does not expect the depreciation of fixed assets to increase in the near future, provided that no large investment is necessary. Depreciation of intangible assets is expected to increase, however, as a result of the acquisition of Flex-Foot. This will be explained in further detail in the section entitled Irregular Depreciation of Goodwill.

Last year, net interest revenue amounted to ISK 6.7 million, which can be explained by a large amount in current assets as a result of Össur's common stock offering. Pre-tax profit amounted to ISK 216 million.

Minority interest amounted to ISK 321 million, and net profit last year was ISK 139.4 million.

Operating Income (EBIT) as percentage of sales



Operating Income has increased from 40 million kroner in 1997 to 209 millions in 1999. As a percentage of sales Operating Income has risen from 5.10% to 16.05% over that period.

**Balance Sheet****Assets**

	Note	Consolidated statement			Parent company		
		1999	1998	1997	1999	1998	1997
<b>Fixed assets</b>							
<b>Intangible assets:</b>	3						
Research costs		11,300.095	16,165.088	24,047.772	11,300.095	16,050.211	21,131.906
Patent		6,794.568	3,272.820	0	6,794.568	3,272.820	0
		<b>18,094.663</b>	<b>19,437.908</b>	<b>24,047.772</b>	<b>18,094.663</b>	<b>19,323.031</b>	<b>21,131.906</b>
<b>Operating fixed assets:</b>							
Buildings and sites	5	11,988.973	11,807.876	23,261.341	11,988.973	11,807.876	23,261.341
Automobiles		14,819.992	12,663.422	14,398.009	11,184.277	10,575.567	10,876.502
Machinery and equipment		39,656.153	33,153.840	49,044.740	36,564.150	29,423.621	37,855.791
Fixtures and furniture		55,842.059	55,560.364	23,261.341	45,997.103	41,478.624	26,779.216
		<b>122,307.177</b>	<b>113,185.502</b>	<b>121,770.517</b>	<b>105,734.503</b>	<b>93,285.688</b>	<b>98,772.850</b>
<b>Long-term investments:</b>							
Loans to subsidiaries	7	0	0	0	117,523.113	180,900.121	159,124.623
Share investments	6	0	0	33,784	1,160,952.258	-962.936	-14,845.037
Bonds	8	1,148,223.583	2,788.057	7,400.000	23,098.644	5,631.056	7,400.000
		<b>1,148,223.583</b>	<b>2,788.057</b>	<b>1,933.784</b>	<b>1,301,574.015</b>	<b>185,568.241</b>	<b>146,179.586</b>
<b>Total fixed assets</b>		<b>1,288,625.423</b>	<b>135,411.467</b>	<b>147,752.073</b>	<b>1,425,403.181</b>	<b>298,176.960</b>	<b>266,084.342</b>
<b>Current assets</b>							
<b>Inventories:</b>	9						
Raw materials and goods in process		50,661.574	36,992.554	37,144.972	50,049.687	36,363.533	27,078.108
Finished products		95,029.448	103,145.541	91,846.386	73,459.513	59,500.556	46,202.251
		<b>145,691.022</b>	<b>140,138.095</b>	<b>128,991.358</b>	<b>123,509.200</b>	<b>95,864.089</b>	<b>73,280.359</b>
<b>Short-term claims:</b>							
Accounts receivables	10	163,433.326	128,120.082	91,853.880	95,155.873	32,075.169	28,337.601
Other receivables	11	40,894.288	27,702.036	21,187.633	39,489.041	14,527.287	21,008.698
		<b>204,327.614</b>	<b>155,822.118</b>	<b>113,041.513</b>	<b>134,644.915</b>	<b>46,602.455</b>	<b>49,346.299</b>
<b>Liquid funds:</b>							
Marketable securities	12	33,842.602	24,270.598	11,007.619	33,842.602	24,270.598	11,007.619
Cash		90,983.746	58,935.575	43,901.377	24,444.040	27,587.058	10,226.694
		<b>124,826.348</b>	<b>83,206.173</b>	<b>54,908.996</b>	<b>58,286.642</b>	<b>51,857.656</b>	<b>21,234.313</b>
<b>Total current assets</b>		<b>474,844.984</b>	<b>379,166.386</b>	<b>296,941.867</b>	<b>316,440.756</b>	<b>194,324.201</b>	<b>143,860.971</b>
<b>Total assets</b>		<b>1,763,470.407</b>	<b>514,577.853</b>	<b>444,693.940</b>	<b>1,741,843.937</b>	<b>492,501.161</b>	<b>409,945.313</b>

**December 31st 1999**

**Liabilities and equity**

	Note	Consolidated statement			Parent Company		
		1999	1998	1997	1999	1998	1997
<b>Equity</b> .....	13						
Share capital .....		211.937.460	4.882.500	4.882.500	211.937.460	4.882.500	4.882.500
Additional paid in capital .....		984.913.993	0	0	984.913.993	0	
General legal reserve .....		15.163.006	1.220.625	1.220.625	15.163.006	1.220.625	1.220.625
Retained earnings .....		174.740.504	177.735.464	96.849.789	174.740.504	177.735.463	96.849.789
<b>Total owners' equity</b>		<b>1.386.754.963</b>	<b>183.838.589</b>	<b>102.952.914</b>	<b>1.386.754.963</b>	<b>183.838.588</b>	<b>102.952.914</b>
Minority interest in net equity (negat.) .....	2	54.778	-223.985	-1.390.925	0	0	0
<b>Tax liabilities</b>							
Deferred income tax .....	14	751.504	6.254.885	9.517.562	11.859.110	13.109.678	9.517.562
<b>Liabilities</b>							
<b>Long-term liabilities:</b> .....	15						
Bank of Iceland, bond payable .....		76.307.709	92.500.319	106.893.472	76.307.709	92.500.319	103.116.065
Bearer bonds .....		81.466.965	77.141.657	76.175.812	81.466.965	77.141.657	76.175.812
Other long-term bonds .....		21.759.251	38.539.165	49.421.219	21.759.251	35.173.446	49.421.219
		179.533.925	208.181.141	232.490.503	179.533.925	204.815.422	228.713.096
Current maturities of long-term debt ..		-17.309.466	-26.523.871	-26.935.827	-17.309.466	-24.588.460	-23.785.562
<b>Long-term liabilities</b>		<b>162.224.459</b>	<b>181.657.270</b>	<b>205.554.676</b>	<b>162.224.459</b>	<b>180.226.962</b>	<b>204.927.534</b>
<b>Current liabilities:</b>							
Current maturities, as above .....	16	17.309.466	26.523.871	26.935.827	17.309.466	24.588.460	23.785.562
Accounts payable .....		63.438.254	40.957.760	50.585.449	47.591.132	32.437.737	43.067.812
Subsidiary liabilities .....		0	0		13.454.475	0	0
Accrued taxes payable .....	17	74.128.135	37.954.142	9.573.134	61.483.758	33.930.389	5.087.683
Other current liabilities .....		20.366.576	10.109.162	6.631.843	7.826.867	1.502.834	2.033.676
Accrued salaries, and other exp. payable		38.442.272	27.506.159	34.333.461	33.339.707	22.866.512	18.572.570
Current liabilities		213.684.703	143.051.094	128.059.714	181.005.406	115.325.933	92.547.303
<b>Total liabilities</b>		<b>375.909.162</b>	<b>324.708.364</b>	<b>333.614.390</b>	<b>343.229.865</b>	<b>295.552.895</b>	<b>297.474.837</b>
<b>.Liabilities and owners' equity</b>		<b>1.763.470.407</b>	<b>514.577.853</b>	<b>444.693.940</b>	<b>1.741.843.937</b>	<b>492.501.161</b>	<b>409.945.313</b>

### Assets

It has been the company's strategy to invest as little as possible in fixed assets, properties, and other tangible assets in order to make maximum use of the Balance Sheet.

Intangible assets at the end of last year amounted to ISK 18.1 million, Research and Development expenses were depreciated by ISK 4.9 million, and depreciation of patents amounted to ISK 1.5 million. All Research and Development expenses incurred last year were charged.

Tangible assets were ISK 122.3 million at year-end, an increase of ISK 9 million.

Investment securities at the end of last year amounted to ISK 1,148 million. This can be explained by the Company's stock offering last year, which raised new capital in the amount of ISK 1,037 million. The objective of the stock offering was to invest further in the Company's operations.

The closing Balance Sheet amounted to ISK 1,763 million.

In August of 1999, Össur hf. acquired a 15% share

in Össur UK Ltd., making it a wholly owned subsidiary of Össur hf. Furthermore, the Company has the right to purchase the entire building at Grjóthals 5, a facility in excess of 5,500 m<sup>2</sup>, for ISK 73,515 per m<sup>2</sup>. The price is index-linked to the construction cost index as of October 1996.

### Liabilities and Stockholders' Equity

At the end of last year, Össur stockholders' equity amounted to ISK 1,386.8 million. Of that amount, capital stock amounted to ISK 211,937,460. Contributed capital in excess of par amounted to ISK 984.9 million, statutory reserves amounted to ISK 15.2 million, and other stockholders' equity amounted to ISK 174.7 million.

### Cash Flow Statement

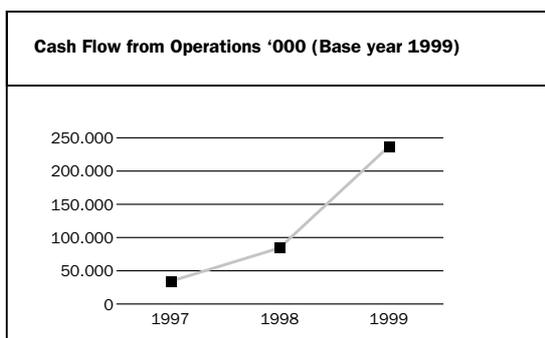
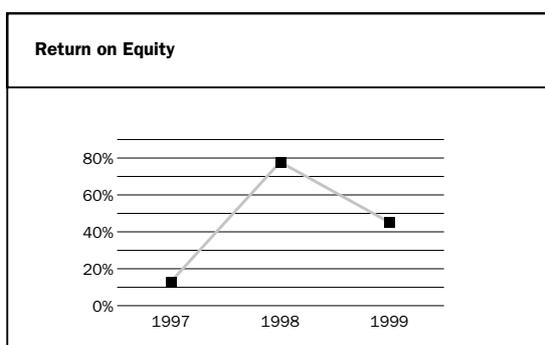
According to the Cash Flow Statement, Össur's net profit amounted to ISK 139.4, and items not affecting cash flow amounted to ISK 48.7 million. The main items that do not affect cash flow are depreciation in the amount of ISK 34.1 million and net price level adjustment in the amount of ISK 20.8 million. Working capital amounted to ISK 188.2 million.

Inventory decreased by ISK 5.5 million, receivables increased by ISK 27.6 million, and current liabilities increased by ISK 79.8 million. Cash and cash equivalents totaled ISK 234.8 million.

Last year, the Company invested in fixed assets for ISK 50.9 million and sold fixed assets for ISK 8.9 million. The Company invested in long-term securities and other receivables for ISK 1,142 million. Cash flow generated by financing activities amounted to ISK 1,183 million.

Last year's installments of long-term debt were ISK 27.4 million, whereas paid-in capital amounted to ISK 1,017.6 million. Cash and cash equivalents at the beginning of the year 2000 amounted to ISK 83.2 million.

In the first two months of the year 2000, the turnover of the consolidated company was ISK 316 million, which is in accordance with the Company's budget. There have been no changes in incurred cost or inventory that could affect the value of the Company.



## Statement of cash flows 1999

	Note	Consolidated statement			Parent company		
		1999	1998	1997	1999	1998	1997
<b>Operating activities</b>							
<b>Net income for the year</b>		139,423,811	79,113,372	11,333,519	139,423,811	79,113,372	11,333,519
<b>Reconciling items not involving cash:</b>							
Depreciation	4	34,100,637	33,249,840	29,383,149	28,471,854	26,899,836	222,656,598
Gain on net monetary position	1	20,766,132	-23,374	-121,061	20,845,977	-1,047	27,545
Indexation and exchange rate difference on long-term debt		-1,996,040	3,263,665	-1,712,955	-1,140,089	3,408,292	-1,773,680
Loss on sale of operating fixed assets		1,059,032	1,054,026	-463,061	147,029	319,428	-349,648
Net change in deferred tax-liability		-5,503,381	-3,262,677	0	-1,250,568	3,592,116	0
Intercompany investment income		0	0	0	-20,273,109	-13,665,307	-58,988,700
Minority interest in net income	2	320,695	1,148,529	936,841	0	0	0
<b>Working capital from operations</b>		<b>188,170,886</b>	<b>114,543,381</b>	<b>39,356,432</b>	<b>166,224,906</b>	<b>99,666,690</b>	<b>25,995,464</b>
<b>Changes in operating assets and liabilities</b>							
Inventories (increase) decrease		-5,552,927	-11,146,737	985,088	-27,645,111	-22,583,730	-2,738,275
Accounts receivable (increase) decrease		-27,617,740	-29,628,153	-6,503,133	-6,380,620	-24,288,533	-14,976,931
Current liabilities (decrease) increase		79,848,015	6,800,391	-1,385,026	72,958,466	21,975,731	8,992,158
<b>Cash provided by operations</b>		<b>234,848,234</b>	<b>80,568,882</b>	<b>32,453,361</b>	<b>205,157,641</b>	<b>74,770,158</b>	<b>17,272,416</b>
<b>Investment activities</b>							
Purchase price of fixed assets		-50,911,986	-34,677,068	-38,356,912	-43,149,948	-30,050,439	-30,849,350
Sales price of fixed assets		8,947,082	14,370,105	6,352,124	8,437,741	11,650,000	1,649,952
Share investments		-7,086	0	0	-1,142,290,291	0	-14,260,922
Long term securities and other receivables		-1,141,521,232	4,405,606	0	-14,887,361	1,559,590	0
<b>Investment activities</b>		<b>-1,183,493,222</b>	<b>-15,901,357</b>	<b>-32,004,788</b>	<b>-1,191,889,859</b>	<b>-16,840,849</b>	<b>-43,460,320</b>
<b>Financing activities</b>							
Maturities on long-term debt		-27,372,343	-36,370,348	11,245,651	-24,476,302	-27,305,966	17,098,460
Paid in capital		1,017,637,506	0	-341,775	1,017,637,506	0	-341,775
<b>Financing activities</b>		<b>990,265,163</b>	<b>-36,370,348</b>	<b>10,903,876</b>	<b>993,161,204</b>	<b>-27,305,966</b>	<b>16,756,685</b>
Change in cash position		41,620,175	28,297,177	11,352,449	6,428,986	30,623,343	-9,431,219
Cash - beginning balance		83,206,173	54,908,996	43,556,547	51,857,656	21,234,313	30,665,532
<b>Cash - closing balance</b>		<b>124,826,348</b>	<b>83,206,173</b>	<b>54,908,996</b>	<b>58,286,642</b>	<b>51,857,656</b>	<b>21,234,313</b>

**Skipting hagnaðar og arðs á hverja krónu nafnverðs hlutfjár er sem hér segir:**

	<b>1999</b>		<b>1998</b>		<b>1997</b>		<b>1996</b>	
	Samstæða	Móðurfélag	Samstæða	Móðurfélag	Samstæða	Móðurfélag	Samstæða	Móðurfélag
Net Income	139.744.507	119.150.703	88.345.974	73.532.140	17.570.020	12.680.935	21.459.418	32.568.309
Number of shares outstanding	211.937.460	211.937.460	4.882.500	4.882.500	4.882.500	4.882.500	4.882.500	4.882.500
Earning per share	0,66	0,56	18,09	15,06	3,60	2,60	4,40	6,67
Distribution	0	0	0	0	341.775	341.775	463.837	463.837
Dividend per share	0,000	0,000	0,000	0,000	0,070	0,070	0,095	0,095

### Budget for the Year 2000

Flex-Foot is included in Össur's Consolidated Statements as of April 1, 2000. A change in the Company's budget thus occurred after that date and supersedes the information contained in the previous offering memorandum, from September 1999, and disclosure of Financial Statements for the year 1999.

It is estimated that the Company's operating income in the year 2000 will amount to ISK 3,410 million and that EBITDA will be ISK 690 million. In evaluating the Company's results and preparing its budget, Össur's management looks mostly at EBITDA because this figure gives the clearest picture of increase in cash and cash equivalents. It is assumed that operating profit before net financial expenses will be a little less than ISK 600 million.

The Company's present assets and estimated growth in the near future indicate that Össur will probably not need to make any large investments in fixed tangible assets. Today Össur's machinery has no problem meeting demands, and Flex-Foot has outside sources producing their products. It is possible, however, that the company will assume control of its own production in the future, if it is deemed profitable. The company

does not expect the need for working capital to increase greatly in the near future.

### Irregular Depreciation of Goodwill

This year, depreciation of goodwill related to the acquisition of Flex-Foot will total ISK 3,150 million. It has been decided to depreciate as much as possible according to generally accepted accounting principles in Iceland. It should be noted that this is an irregular figure whose only effect on financial income is to decrease the future tax liability of the group.

According to the Company's budget, it is estimated that operating losses this year will amount to ISK 2,800 million. Össur's management believes it to be an acceptable outcome because financial income is strong and the loss is only a figure in the Company's accounts.

The reason for depreciating as much as possible now is to be as cautious as possible in the Company's operations. Furthermore, it is not beneficial to keep a large amount of goodwill in the Company's books if an opportunity should arise to acquire other companies.

### Pro Forma Income Statement for the year ended 2000

	<b>3.4.2000</b>	<b>31.12.2000</b>
Million ISK		
Intangibles and Property, Plant, and Equipment, net	5.050	1.955
Current Assets	940	950
	<b>5.990</b>	<b>2.905</b>
Shareholders' Equity	4.819	1.995
Current Liabilities	465	505
Long-Term Debt	705	405
	<b>5.990</b>	<b>2.905</b>

Net Sales	3410
Cost of Sales	2720
EBITDA	690
Depreciation	90
Operating Income	600
Interest Expense	115
Income before Tax Provision	485
Income Tax Provision	85
Amortization of Intangible assets	70
<b>Net income before subsidiaries</b>	<b>330</b>
Depreciation of Goodwill	3150
<b>Net Income</b>	<b>-2820</b>



## IX. Risk Factors

Risk factors in Össur's operation, which the Company's management can influence only to a small extent or not at all, are of various kinds. These risk factors can have serious consequences on the Company's performance. The risk factors are as follows:

- **Staff Risk**

As a company with extensive expertise, Össur is extremely dependent on key employees. The Company tries to ensure their loyalty by paying them competitive wages and by granting them stock options. As Össur strives to attract competent employees, other companies are likely to make better offers. In cases when they are successful, the Company loses valuable experience and expertise.

- **The Dilution of Capital Stock**

The Company may increase its capital stock in the future in order to finance the acquisition of other companies in related operations.

If the return on Össur's shares is better than the Main List Index, employees will be offered stock options. Furthermore, stock option agreements are now being concluded with Flex-Foot key employees. The Board's authorization to allocate new capital stock to stock option agreements and to acquire other companies without resorting to pre-emptive rights of stockholders

according to the present Articles of Association can cause a dilution of capital of up to 10.8%.

- **Market Access**

Demands on companies in the healthcare sector for quality certification and clinical research are continually increasing, and thus the size of companies will be increasingly important in order for them to be able to bear the cost following increased demands.

- **Rapid Growth**

The Company's management is facing the new task of combining two rapidly growing companies.

- **Different Cultures**

Through the acquisition of Flex-Foot, Össur has become a multinational company. Experience shows that such mergers are complicated and differences in opinion can spoil cooperation.

- **External Conditions**

Changes that could take place are mostly related to decisions made by authorities and insurance companies. Decisions, such as the reduction of financing for healthcare or individual sectors thereof, (such as the prosthetics sector) could affect the operation.

- **Cost of Patents**

The Company has marked the policy to protect its patents in a more assertive manner than before. All litigation costs associated with violations of the Company's patents by competitors are thus liable to increase in future. The cost of the merged company amounts to ISK 23 million in 1999.

- **Litigation**

Litigation is common in the health product market. Össur has had its share and several court cases are presently ongoing. The Company's management, however, is of the opinion that none of these are of such a nature as to affect the value of the Company. Whereas the Company is insured for damages and costs incurred as the result of litigation, it can never obtain insurance against damage to the Company's reputation that litigation may cause.

- **Amendments of Regulations**

Extensive debate has taken place in the United States and in other markets about the organization of healthcare provision that could affect the Company's financial performance. The organization of these issues in the future depends on political factors upon which the Company cannot have any impact.

- **Competition**

To date, the number of manufacturers has grown without creating a great threat to the market share. However, competition may increase in the socket market. This could happen in two ways: on the one hand, there will be other companies in the future that manufacture and sell products in direct competition with Össur, which could affect the Company's market share. On the other hand, a merger in the prosthetic market, a vertical assimilation of distribution and production companies, could affect Össur's access to the sales system.

- **Distribution Systems**

Össur sells its largest portion of products through distributors and has strived to form strong connections with the relevant companies, while trying not to become too dependent on any one party.

Risk is, however, always present in such sales arrangements because there might be a marketing disruption if problems occur in the relationships between Össur and its distributors. By the purchase of Flex-Foot, Össur will acquire its own sales system in the United States and work is ongoing to set up a sales system in Europe. It might take some time to add product lines to that sales system, and this may cause a disruption in the sale of Össur products.

- **Product Liability**

In the healthcare sector, the producers' liability for the functionality and safety of their products is considerable. This risk can be minimized through active quality control and tests, as described in the chapter on quality issues. The Company is well insured both for all expenses that may be incurred by the recalling of faulty products as well as liability claims from individuals and/or insurance companies. This insurance amounts to up to ISK 100 million for products and people, while export value is insured for the same amount. The Company has an additional ISK 70 billion recall insurance that covers the cost that may be incurred by the recalling of a product. This liability insurance is reviewed on a regular basis in light of the turnover and the scope of the operation.

- **Suppliers**

Relatively few suppliers supply materials for the production. The Company's largest suppliers are the manufacturers of carbon fibers and silicon for the Company's products, and so the Company is rather dependent on purchases through them. The Company is setting up a reaction plan in case this connection should break.

- **Production**

External conditions, such as fire, earthquakes or other natural disasters could have a serious effect on the Company's production. Production equipment could be installed that might be used in such cases. This would, however, only amount to a fraction of the Company's production.



## Appendix

V2



## B. Össur's Acquisition of Flex-Foot, Inc.

On March 6, 2000, Össur signed a contract concerning the acquisition of Flex-Foot for a price of USD 75 million. The purchase agreement states that USD 72 million, less long-term liabilities and changes in current assets, was paid on April 3, 2000, and USD 3 million will be paid over the next three years. Total payment for Flex-Foot's assets on April 3rd amounted to USD 70,835,670.

After the acquisition of Flex-Foot, Össur's policy and aim have not changed, even though the picture has changed dramatically and the Company's opportunities for growth in the prosthetics market has increased.

Össur's objective before the acquisition of Flex-Foot was to invest in the prosthetics industry in the most economical way possible, either by investing in its own operations or by acquiring other companies. Össur's management believes that the acquisition of Flex-Foot represents the realization of two goals: the completion of the Company's product line, which enables Össur to offer amputees a comprehensive solution, and the acquisition of a sales system through Flex-Foot.

Flex-Foot® is the most valuable trademark for artificial ankles, and Mauch has a good reputation for its artificial knees. Before the acquisition, the Masterstep artificial ankle represented an insubstantial part of Össur's income, and Össur did not produce artificial knees. It has been Össur's goal to penetrate these markets further, but such market penetration would have been a lengthy process because it takes a long time for products in the health market to be recognized. The three companies, Össur hf., Flex-Foot, Inc. and Mauch Inc., will be operated separately for the time being, and the Company will retain these valuable trademarks.

Össur's management is optimistic about the Flex-Foot sales system and the Company's access to it. Because of this, expensive intermediaries in the sales system can be eliminated, and the portion of markup that would otherwise be paid to distributors can be kept within the consolidated company. Furthermore, the Company will be in a better position to control its image and marketing.

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## C. Flex-Foot Income Statement

# CONSOLIDATED STATEMENT OF INCOME 1999

	\$ 1999	\$ 1998
<b>NET SALES</b> .....	27.957.000	21.765.000
	27.957.000	21.765.000
<b>COST OF SALES</b>		
Cost of products sold .....	12.052.000	9.756.000
Sales, marketing, and technical services .....	4.791.000	3.480.000
Research and development .....	2.077.000	2.407.000
General and administrative .....	4.158.000	3.051.000
	23.078.000	18.694.000
Earnings before interest taxes depreciation and amortization .....	4.879.000	3.071.000
Amortization of developed technology .....	(1.004.000)	(1.763.000)
Amortization of intangible assets .....	(277.000)	(208.000)
<b>OPERATING INCOME</b> .....	3.598.000	1.100.000
INTEREST EXPENSE, net .....	(544.000)	(444.000)
OTHER INCOME, net .....	43.000	115.000
<b>INCOME BEFORE INCOME TAX PROVISION</b> .....	3.097.000	771.000
INCOME TAX PROVISION .....	(23.000)	(38.000)
<b>NET INCOME</b> .....	3.074.000	733.000

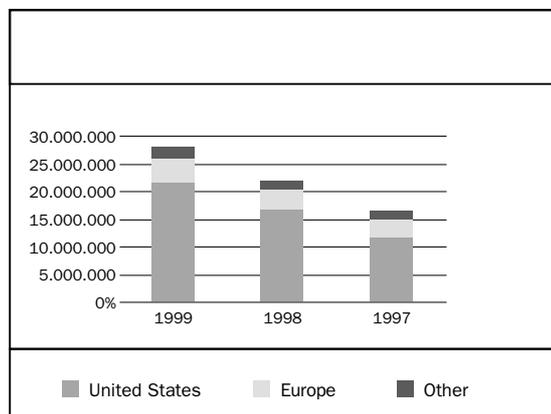
Flex-Foot's income last year amounted to USD 28 million (ISK 2,028 million), an increase of 28.4% from the previous year. Cost of goods sold was USD 12 million, or 43.1% of turnover, as opposed to 44.8% of turnover for the previous year. Sales and marketing expenses, along with technical services, amounted to USD 4.8 million and were up by 37.7%; Research and Development amounted to USD 2.1 million, or 7.4% of turnover; and administrative and office expenses were USD 4.2 million, an increase of 14.9%.

Operating revenue before depreciation, the figure that Össur's management considers an indicator of the added value of Flex-Foot to the Company, amounted to USD 5.6 million (ISK 407 million). In the Company's Income Statement, only the depreciation of intangible assets is accounted for separately, but total depreciation can be seen in the Cash Flow Statement. Depreciation amounted to USD 2 million, compared to USD 2.5 million the previous year. The chief difference is explained by depreciation relating to the acquisition of Mauch, Inc., USD 1 million in 1999 and USD 1.8 million in 1998.

### Sales by Markets

All numbers US\$

	1999	1998	1997
United States	21.478.000	16.765.000	11.555.000
Europe	4.486.000	3.365.000	3.292.000
Other	1.993.000	1.635.000	1.504.000
	<b>27.957.000</b>	<b>21.765.000</b>	<b>16.351.000</b>



Operating profit before financial income and expenses in 1999 amounted to USD 3.6 million (ISK 261 million), as compared with USD 1.1 million the preceding year. This is equivalent to 12.9% of turnover in 1999. Financial expenses amounted to USD 544,000, and net income before extraordinary items amounted to USD 31 million.

The company paid income tax in the amount of USD 23 thousand. Össur is classified as an S-Corporation, which means that the Company's owners pay income tax but the Company itself does not. This will change when new owners assume control.

Net income before extraordinary items amounted to USD 3 million. Extraordinary income and net profit amounted to USD 3.1 million (ISK 223 million).

# CONSOLIDATED BALANCE SHEET

## ASSETS

	31. 12. 1999	31. 12. 1998
	\$	\$
<b>CURRENT ASSETS</b>		
Cash .....	740.000	773.000
Accounts receivable, less allowance for doubtful accounts of \$45.000 and \$22.000 at December 31, 1999 and 1998 .....	3.351.000	2.497.000
Inventories, net .....	2.005.000	1.783.000
Prepaid expenses and other current assets ..	243.000	132.000
Total current assets	6.339.000	5.185.000
INTANGIBLE ASSETS, net .....	1.332.000	2.613.000
PROPERTY, PLANT AND EQUIPMENT, net .....	5.593.000	4.349.000
	13.264.000	12.147.000

## Balance Sheet

### Assets

Flex-Foot's current assets at year-end 1999 amounted to USD 6.3 million, which is 22.7% of turnover as compared with 23.8% of turnover in 1998 and 19.2% of turnover in 1997. Accounts receivable amounted to USD 3.4 million, or 12% of turnover, as compared with 11.5% of turnover at year-end 1998. Inventory amounted to USD 2 million, or 7.2% of turnover, compared to 8.2% in the preceding year.

Flex-Foot's operational fixed assets at year-end 1999 amounted to USD 5.6 million, an increase of USD 1.2 million from the preceding year. Of this amount, USD 762,000 was invested in computers. Last year the Company invested in a new computer system and began using a new integral Fourth Shift computer system (Enterprise Resource Planning).

Intangible assets amounted to USD 1.3 million, compared to USD 2.6 million at the end of 1998. This is explained by goodwill in connection with the acquisition of Mauch.

Flex-Foot's total assets at the end of 1999 amounted to USD 13.3 million (ISK 962.3 million).

# December 31, 1999

## LIABILITIES AND SHAREHOLDERS' EQUITY

	31. 12. 1999	31. 12. 1998
	\$	\$
<b>CURRENT LIABILITIES:</b>		
Accounts payable . . . . .	1.028.000	688.000
Accrues royalties and license fee . . . . .	323.000	303.000
Accrued warranty . . . . .	336.000	282.000
Other accrued liabilities . . . . .	1.948.000	1.379.000
Current portion of long-term debt and acquisituin cost . . . . .	2.386.000	1.797.000
Total current liabilities	6.021.000	4.449.000
LONG-TERM DEBT, less current portion . . . . .	5.165.000	6.274.000
Common stock . . . . .	321.000	321.000
Retained earnings . . . . .	1.757.000	1.103.000
Total shareholder' equity	2.078.000	1.424.000
	13.264.000	12.147.000

**Liabilities and Equity**

Flex-Foot's current liabilities at the end of 1999 amounted to USD 6 million (ISK 437 million). Long-term liabilities amounted to USD 5.2 million dollars but will be refinanced along with the acquisition.

Flex-Foot's stockholders' equity amounted to USD 2.1 million at the end of 1999.

# CONSOLIDATED STATEMENT OF CASH FLOWS

	1999	1998
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income . . . . .	3,074,000	733,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization . . . . .	2,008,000	2,544,000
Increase in allowance for doubtful accounts	23,000	10,000
Increase in allowance for obsolete inventory	21,000	91,000
Loss on disposal of property, plant, and equipment . . . . .	41,000	12,000
Changes in operating assets and liabilities, net of effects of the acquisition		
Accounts receivable . . . . .	(877,000)	(22,000)
Inventories . . . . .	(243,000)	(556,000)
Prepaid expenses and other current assets	(111,000)	(15,000)
Accounts payable . . . . .	340,000	(144,000)
Accrued royalties and license fee . . . . .	20,000	49,000
Accrued warranty . . . . .	54,000	46,000
Other accrued liabilities . . . . .	569,000	273,000
Net cash provided by operating activities	4,919,000	3,021,000
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property, plant, and equipment . . . . .	(2,012,000)	(698,000)
Decrease in other assets . . . . .	0	21,000
Cash paid for acquisition and related costs, net of cash acquired . . . . .	0	(3,958,000)
Net cash used in investing activities	(2,012,000)	(4,635,000)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Distributions to shareholders . . . . .	(2,420,000)	(1,694,000)
Proceeds from sale of property, plant, and equipment	0	64,000
Net proceeds from long-term borrowings . . . . .	434,000	4,000,000
Repayment of long-term debt . . . . .	(954,000)	369,000
Net cash (used in) provided by financing activities	(2,940,000)	2,739,000
NET (DECREASE) INCREASE IN CASH . . . . .	(33,000)	1,125,000



## Notes to the financial statements

### Summary of accounting policies

#### 1. Presentation and consistency

In preparing the financial statements the accounting principles are, in all material respects, consistent with those of the preceding year. The financial statements are prepared according to the IAS principles, adjusted for the effects of general price level changes as described in the following paragraph. The inflation rate in Iceland in 1999 was 5.61%.

#### Effects of general price changes

The financial statements have been adjusted for the effects of general price-level changes on the Company's operation and financial position. The adjustment is based on the changes in the Consumer Price Index. In 1999 the index rose by 5.61%. The following methods were used:

- The effect of general price-level changes on monetary assets, inventories and liabilities at the beginning of the year and their changes during the year have been calculated and are accounted for in the financial statements. Since the net monetary position including inventories was positive during the year, a net debit entry of ISK 20.8 million is included in the calculation of profits. The counterbalancing entry is to the Revaluation Account under Owners' Equity.
- The book value of Intangible Assets and Operating Fixed Assets is revalued to 1999 year-end prices based on the increase in the CPI-index. The revision is posted to the revaluation account under owner's equity. Depreciation and amortization of fixed assets is recorded in the Income Statement at the year's average price level.
- Assets and liabilities denominated in foreign currencies are presented in Icelandic currency (ISK) at the rate of exchange prevailing at the end of the year. Operating income and expenses in foreign currencies are converted to ISK at the exchange rate of the date of transaction.

#### 2. Consolidation

The consolidated financial statements pertain to the following subsidiaries:

Ownership	share
Össur USA, Inc	100%
Össur Luxembourg, S.A.	100%
Össur stodtaeki hf. (Ltd.)	90%
Össur UK, Ltd	100%
Össur Holding	100%

The consolidated financial statements are prepared in conformity with the purchase method of accounting; the minority interest stems from Össur stodtaeki hf. (Ltd). Each amount in the balance sheets of the foreign subsidiaries is converted to ISK at the end-of-year rate of exchange, but amounts in the income statements of the foreign subsidiaries are converted to ISK at the average year rate of exchange.

One of the purposes of consolidated accounts is to show only the net revenues, expenses, assets and liabilities of the group as a whole. Hence, intergroup transactions have been eliminated within the group in the presentation of the consolidated financial statements. Unrealized gain in inventories resulting from intergroup transactions has been eliminated, and taxes adjusted accordingly.

#### 3. Intangible assets

Intangible assets recorded include capitalized research & development costs of previous years and the capitalized cost for a new patent in 1999. Intangible assets are revaluated and expensed on a straight line basis for a period of five years. All incurred research and development cost in 1999 is expensed.

#### Intangible assets:

Restated cost 1.1.1999	30.841.376
Accumulated amortization	<u>(11.518.345)</u>
Book value 1.1.1999	19.323.031
Revaluation	1.076.996
Investment in 1999	4.658.880
Amortization in 1999	<u>(6.964.244)</u>
Book value 31.12.1999	<u>18.094.663</u>

#### Fixed assets

4. Depreciation on fixed assets is calculated on a straight line basis. The amounts recorded are based on the restated historical cost at year end. The following rates are used:

Automobiles	10–20%
Machinery and equipment	12%
Computer hardware	33%
Office equipment	15%
Fixture and furniture	10%
Buildings and sites	3%

- Changes in the fixed assets accounts of the company consist of the following:

	Building and sites	Automobiles	Machinery and equipment	Fixtures and furniture	Total
Restated cost at 1.1.1999	17.273.053	15.333.425	69.188.974	57.161.356	158.956.808
Accum.depr. at 1.1.1999	<u>(5.465.177)</u>	<u>(4.757.858)</u>	<u>(39.765.353)</u>	<u>(15.682.732)</u>	<u>(65.671.120)</u>
Book value 1.1.1999	11.807.876	10.575.567	29.423.621	41.478.624	93.285.688
Revaluation in 1999	648.873	772.198	1.575.142	2.423.525	5.419.738
Investment in 1999	0	11.863.906	14.532.935	12.094.227	38.491.068
Retired/sold	0	(9.954.380)	0	0	(9.954.380)
Depreciation in 1999	<u>(467.776)</u>	<u>(2.073.014)</u>	<u>(8.967.548)</u>	<u>(9.999.273)</u>	<u>(21.507.610)</u>
Book value 31.12.1999	<u>11.988.973</u>	<u>11.184.277</u>	<u>36.564.150</u>	<u>45.997.103</u>	<u>105.734.503</u>
Fixed assets of subsidiary companies					<u>16.572.674</u>
					<u>122.307.177</u>

Depreciation in the Income Statement for 1999 consists of the following:

Fixed assets, depreciation (average price-index)	21.507.610
Patent, amortization	1.469.161
	22.976.771
Subsidiaries depreciation	5.628.783
	28.605.554

5. At year end 1999 the official assessment and fire insurance value of buildings was as follows:

	Assessment value	Fire insurance value	Book value
Real estate	15.107.000	28.558.000	9.779.674
Land	3.166.000		2.209.299
	<u>18.273.000</u>	<u>28.558.000</u>	<u>11.988.973</u>

#### Share investments

6. Shares in subsidiaries:

	Book value 1.1	Operating income	Translation Difference	Paid in on capital stock	Book value 31.12.1999
Össur stoðtæki	(170.505)	673.071	(9.565)	0	493.001
Össur USA	(3.672.030)	7.446.243	269.661		4.043.874
Össur UK	(2.093.845)	9.482.320	(25.028)	40.870	7.404.317
Össur LUX	4.973.444	3.191.631	(917.058)		7.248.017
Össur Holding	0	(520.156)		1.142.283.205	1.141.763.049
	<u>(962.936)</u>	<u>20.273.109</u>	<u>(681.990)</u>	<u>1.142.324.075</u>	<u>1.160.952.258</u>

- Share investments and intercompany investment income have been reduced by unrealized gain in inventories resulting from intergroup transactions. The unrealized gain, net of income tax effect, is ISK 24.5 million.
7. The operation of the subsidiaries' inventories, receivables and operating fixed assets is financed by the parent company. Material repayments from the subsidiaries are not expected in year 2000.

#### Securities

8. Long-term securities, as defined by management, are intended for future expansion and growth of the company. Long term securities are recorded at market value at year-end and they are classified as follows (ISK million):

Bonds and bills of exchange	868
Interest-bearing bonds	210
Equity securities and share certificates	70
	<u>1.148</u>

#### Inventories

9. Inventories are valued at the lower of cost or market. Finished products in the consolidated statements have been reduced by unrealized gain from intergroup transactions.

#### Short-term claims

10. Accounts receivable are valued at cost plus incurred interest, less allowance for doubtful receivables, or ISK 2.5 million in 1999.

11. Other receivables:

Value added tax, refund	19,047,899
Prepaid expenses and miscellaneous	20,441,142
	<u>39,489,041</u>
Other receivables in subsidiary companies	1,405,247
	<u>40,894,288</u>

12. Marketable securities

Marketable securities are valued at year-end market rate in a Monetary Fund. The securities are readily accessible.

#### Owners' equity

13. At the beginning of the year owners' equity approximated ISK 183.8 million or ISK 194.1 million in terms of the 5.61% price-index change in 1999. At the end of the year owners' equity amounted to ISK 1,386.8 million. Changes in the owners' equity consist of the following during 1999:

Changes in the owners' equity accounts consisted of the following during 1999:

	Nominal value	Year-end value
Owners' equity 1.1 1999	183.838.588	194.146.359
Paid-in capital	1.036.851.453	1.049.350.867
Income for the year	139.423.812	143.257.737
Inflation-adjustment	26.641.110	0
	<u>1.386.754.963</u>	<u>1.386.754.963</u>

	Share Capital	Additional paid in capital	General legal reserve	Retained earnings	Total
Beginning balance	4.882.500	0	1.220.625	177.735.463	183.838.588
Paid-in capital	51.937.460	984.913.993			1.036.851.453
Issued stock dividend	155.117.500			(155.117.500)	0
Revaluation of fixed assets				5.795.133	5.795.133
Price level changes - loss				20.845.977	20.845.977
Statutory reserve appropriation			13.942.381	(13.942.381)	0
Income for the year				139.423.812	139.423.812
	<u>211.937.460</u>	<u>984.913.993</u>	<u>15.163.006</u>	<u>174.740.504</u>	<u>1.386.754.963</u>

#### Deferred income tax

14. An income tax liability of ISK 11.9 million is recognized in the financial statements of the parent company. The calculation of the income tax liability is based on the difference between the financial statements and the tax statements of the company, mainly depreciation and allowance for doubtful receivables. Payment of income tax has been postponed to future periods, in accordance with tax law, and an income tax liability is recognized.

A decrease in the income tax liability from the previous year of ISK 1.2 million decreases expensed income tax in the Income Statement.

The consolidated income tax liability is ISK 0.8 million compared to ISK 11.9 million for the parent company. The difference is explained by the tax effect of the elimination of unrealized gain from intergroup transactions, as described in note 6.

#### Long-term liabilities

15. The long-term debt is recorded in terms of the price level at the end of the year. The fixed assets of the company have been pledged as security for these loans. The long-term debt consists of the following at the end of 1999:

	Interest	Remaining balance
Íslandsbanki (bank)	5-7,8%	76.307.709
Bond issue	7,1%	81.466.965
Fjárvangur, investment comp.	6,0%	3.270.640
Lýsing, leasing comp.	5,9-7,2%	4.507.017
Bond payable	4,5%	7.618.000
FBA, investment bank	3-6,5%	6.363.594
		<u>179.533.925</u>

16. The repayment schedule of long-term liabilities is as follows:

Year due:

2000	17,309,466
2001	154,572,719
2002	3,854,490
2003	2,273,652
Later	<u>1,523,598</u>
	<u>179,533,925</u>

#### Taxation

17. A provision has been made in the financial statements for the payment of taxes.

Income tax:

Calculated income tax levied in 2000	60.590.348
Decrease in income tax liability	<u>(1.250.568)</u>
	59.339.780
Subsidiaries' income taxes	<u>14.502.039</u>
	<u>73.841.819</u>
Accrued taxes payable:	
Income tax	60.590.348
Net worth tax	2.452.772
Industrial tax	864.689
Prepaid taxes	<u>(2.424.051)</u>
	61.483.758
Subsidiaries taxes	<u>12.644.377</u>
	<u>74.128.135</u>

#### Insurance

18. Össur hf. is insured against a temporary work stoppage of general operations for ISK 184 million.
19. Fixed assets, other than buildings, are insured for ISK 335.2 million.

#### Related party transactions

20. At the end of 1999 the parent company has claims against subsidiary companies in the amount of ISK 117.5 million. The total amount of intercompany sales was ISK 588 million during 1999. These intercompany balances and intercompany sales and transactions have been eliminated in the consolidated financial accounts.

#### Other items

21. The company has taken on lease the ground floor and the first floor at Grjótháls 5, Reykjavík. The lease expires in the year 2007. In addition, the company has an option to purchase the building, as a whole, with three months' prior notice at a fixed price pr. square meter. The cost price will be affected by changes in the general price level. In 1999 the company's lease payments for Grjótháls 5 amounted ISK 28.7 million.
22. At the end of the year ISK 125 million of the company's assets and ISK 76.4 million of the company's debt were in foreign currencies.

23. Sales according to market areas:

North America	47%
Europe (exclusive of Iceland)	49%
Iceland and other countries	<u>4%</u>
	<u>100%</u>

24. Interest income and expense:

	Consolidated		Parent company	
	1999	1998	1999	1998
Interest income	45.950.328	1.693.194	45.095.073	1.351.460
Dividend payments	0	0	1.689	1.689
	45.950.328	1.693.194	45.096.762	1.353.149
Interest expense & exchange rate difference	(18.494.284)	(24.745.139)	(16.544.435)	(23.476.162)
General price level gain (loss)	(20.766.132)	23.374	(20.845.977)	1.047
	6.689.912	(23.028.571)	7.706.349	(22.121.966)

25. Salaries and related expenses:

Salaries, parent company	241.823.813
Related expenses, parent company	39.559.499
	<u>281.383.312</u>
Salaries and related expenses in subsidiaries	63.360.792
	<u>344.744.104</u>

In addition, salaries and royalties of ISK 45.8 million are expensed in the Income Statement as Research and Development costs.

Össur hf. loaned employees ISK 13.4 million in 1999 to buy shares in the company. The loans are not interest-bearing and the credit period is two years.

Salaries to the Chief Executive and fees to the Board of Directors amounted to ISK 17.8 million in 1999. No share benefits, loans or collateral have been granted to these individuals.

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## ARTICLES OF ASSOCIATION FOR ÖSSUR H/F

1. Name of the Company, Domicile and Object
2. Share Capital of the Company
3. Organisational Structure
4. Shareholders' Meetings
5. The Board of Directors of the Company
6. Chief Executive Officer
7. Accounts and Auditing
8. Own Shares Held by the Company
9. Amendments to the Articles of the Company
10. Dissolution of the Company
11. Further Provisions

27. October 2000

## ARTICLES OF ASSOCIATION

for the Limited Liability Company

Össur hf.

### 1. Name of the Company, Domicile and Object

- 1.01 The name of the Company is Össur hf.
- 1.02 The Company is a limited liability company.
- 1.03 The domicile of the Company is Grjótháls 5, Reykjavík.
- 1.04 The object of the Company is the development and sale of prosthetic devices and components in the field of orthopaedics and rehabilitation therapy as well as various types of services to the health professions and patients. The operation of workshops for prosthetic devices, the development and sale of products for other uses, investment and participation in other companies and other related business.

### 2. Share Capital of the Company

Share Capital – Shares

The share capital of the Company amounts to ISK 282,149,540 – two hundred and eighty two million one hundred forty nine thousand five hundred and forty Icelandic krónur – which has been paid in full. (Amended at Board meetings 28 March 2000, 30 June 2000 and 27 October 2000)

The Board of Directors of the Company is authorised to increase the share capital of the Company in stages during the next five years by up to ISK 5,766,895 – five million seven hundred and sixty six thousand eight hundred and ninety five Icelandic krónur – through the sale of new shares to selected investors. The offer price and terms of payment are according to special agreements entered into by the Board of Directors of the Company with each investor. The pre-emptive rights detailed in these Articles of Association shall not apply to this increase in share capital. (So amended at the Board Meeting of 30 June 2000)

The Board of Directors of the Company is also authorised to increase the share capital of the Company in stages over the next five years by up to ISK 7,083,565 – seven million eighty three thousand five hundred and sixty five Icelandic krónur – in addition to the above authorisation for the increase of share capital, with the sale of new shares to new investors. The pre-emptive rights detailed in these Articles of Association shall not apply to this increase in share capital. The Board of Directors of the Company shall determine the offering price of the shares and sales procedures at each time. The Board of Directors shall decide the nominal value of the new shares and their price, deadlines for subscriptions and payments. Subscriptions shall proceed in full conformity with the provisions of the Articles of Association of the Company and Chapter V of Act No. 2/1995 on Limited Liability Companies, with the exception of the Article on pre-emptive rights. (So amended at the Board Meeting of 27 October 2000)

The Board of Directors is also authorised to increase the share capital of the Company in stages during the next five years by up to ISK 10,000,000 through the sale of new shares to key personnel within the Company. The Board of Directors may decide the offering price and sales procedure of the shares according to a special agreement which the Board enters into with the employee in question each time. The Board may deviate from the listed sales price of the shares on the Stock Market at the time that said agreement with an employee is concluded. The article on pre-emptive rights in these Articles of Association shall not apply to this part of an increase in share capital. (So amended at the Annual General Meeting 24 March 2000. So amended in accordance with the decision made by the Board of Directors 28 March 2000 on the increase of share capital by ISK 60,000,000)

The share capital may be divided into shares as convenient. One share certificate may be issued for the total share capital of each shareholder in the Company; the same applies to increases in share capital, cf. Section 2.02.

The Company is under obligation to divide its shares into smaller units on receipt of a reasoned request to this effect, e.g. upon the settlement of an estate.

Increase in Share Capital – Pre-emptive Rights

- 2.02 Only shareholders' meetings may decide on an increase in the share capital of the Company, whether through subscription to new shares or through the issue of bonus shares.

The increase shall follow the rules set by a shareholders' meeting each time. Shareholders have pre-emptive rights to all new share capital in proportion to their registered holdings; deviation from this provision is permitted, however, cf. Paragraph 3. Article 34. of the Act on Limited Liability Companies, if a shareholders' meeting so approves with 2/3 of the votes in the Company.

Share Certificates – Share Ledger

- 2.03 When a shareholder has paid his share in full, he shall be delivered a share certificate issued and signed by the Board of Directors of the Company, which entitles him to all rights provided for in the Company's Articles of Association.
- 2.04 The Company's share certificates shall be consecutively numbered, and issued in the name of the holder. The Share certificates shall specify the following:

- a) The address and Id. No. of the shareholder and the Company.
- b) The amount of the share, the number of the certificate and the date of issue.
- c) Any restrictions on the shareholders' authorisation for the disposal of his/her shares.
- d) Authorisation to invalidate a share without a court decision.

The Board of Directors of the Company shall maintain a share ledger, which shall specify the following:

- a) Date of issue.
- b) The nominal value and number of each share certificate;
- c) To whom the share was issued, his/her address and Id. No. Furthermore, the date of the transfer and date of registration shall be entered.
- d) Any changes which may take place in the relationship between the Company and the owner of the share certificate, e.g. if the certificate is invalidated with or without a court decision.

For the Company, the Share Ledger shall be regarded as full proof of ownership rights to any shares in the Company, and dividends at any time, as well as all notices, shall be sent to the party registered at any time as the owner of the shares in question in the Share Ledger of the Company. The Company assumes no responsibility for payments or notices being lost owing to failure to notify the Company of changes of address.

In the event of the loss of a share certificate, the owner shall receive a new certificate as soon as the Board of Directors of the Company has received proof that a court invalidation has been obtained for the lost certificate or that it has been invalidated by the publication of a notice in the Official Gazette, which procedure shall be entirely at the owner's expense. Should a certificate be damaged, but there is no mistake as to the number of the certificate or its substance, the owner may be issued a new certificate at his own cost on return of the damaged certificate.

Shares may be issued electronically, in accordance to the decision of the Board of Directors of the Company, pursuant to the Act on Electronic Registration of Securities.

#### Ban on granting loans.

- 2.05 The Company shall not grant loans against shares in the Company.

The Company shall neither grant shareholders, Board members or the Chief Executive Officer (CEO) of the Company loans nor provide them with guarantees. The provisions of this Article do not, however, apply to normal business loans.

#### The Sale of Shares.

- 2.06 There are no restrictions on the disposal of shares in the Company.
- 2.07 Each shareholder shall inform the Company of his/her address and all notices of Company matters may be sent to that address. In the event that shareholders neglect to provide information of such address, they shall have neither any claim to receive any notice that the Board of Directors may decide to send to shareholders, unless the Board of Directors has knowledge of their address, nor any claim to remittance of dividend payments. However, shareholders may collect their dividends at the Company office within four years after payment was due.
- 2.08 Each shareholder is bound, without specific undertaking on their part, to abide by the Articles of the Company in their present form or as lawfully amended at any time. However, shareholders may not be obligated on the basis of the Company Articles or amendments thereto to increase their holdings in the Company or to sell their shares or suffer redemption of their shares. Shareholders are not liable for the commitments of the Company beyond their share in the Company unless they assume such commitments under a separate legal instrument. This provision may not be amended nor deleted by any resolution of a shareholders' meeting.

No privileges are attached to any shares in the Company.

### 3. Organisational Structure

- 3.01 The Company is managed by:

1. Shareholders' Meetings
2. The Board of Directors of the Company
3. The CEO

### 4. Shareholders' Meetings

- 4.01 The supreme authority in all affairs of the Company, within the limits established by these Articles and statutory law, is in the hands of lawful shareholders' meetings.

#### Proxies

A shareholder may appoint a proxy to attend a shareholders' meeting on his behalf. The proxy shall submit a written and dated letter of proxy.

Letters of proxy shall not be valid for longer than 5 years from their date of issue. A letter of proxy may not be revoked with effect for the Company after it has been submitted on delivery of the documents of the meeting, or after the shareholders' meeting has been called to order, whichever occurs first.

#### Shareholders' Meetings

A shareholders' meeting is valid, regardless of attendance, if the meeting has been lawfully convened.

#### Annual General Meeting

- 4.02 The Annual General Meeting shall be held before the end of June each year.

The Annual General Meeting shall be called in the same manner as other shareholders' meetings.

#### The Agenda of the Annual General Meeting

The Agenda of the Annual General Meeting shall include the following:

1. The report of the Board of Directors on the activities of the Company in the preceding year;
2. Confirmation of the annual accounts of the Company for the preceding year.
3. Decision on the remuneration of the Members of the Board of Directors;
4. Decisions made on the disposal of profits or losses of the Company over the accounting year;
5. Elections to the Board of Directors, cf. Section 5.01;
6. Election of an auditor, cf. Section 7.02;
7. Any other business lawfully submitted or approved for discussion by the Meeting.

In the event that shareholders controlling at least 1/3 of the shares so request in writing at the Annual General Meeting, decisions on items 2 and 4 shall be postponed to an adjourned Annual General Meeting, which shall be held at the earliest one month and at the latest two months later. Further postponement cannot be requested.

#### Convening of Shareholders' Meetings

Shareholders' meetings shall be convened by a notice in the media, by post, telegram, facsimile, or e-mail.

Shareholders' meetings shall be convened with at least two weeks' notice.

The notice of the meeting shall state the business of the meeting.

#### Rules of Order

Shareholders' meetings shall be convened at the discretion of the Board of Directors, by a resolution of a meeting, or if the elected auditors or shareholders holding a minimum of 1/10 of the shares of the Company request a meeting and state the business of the meeting.

Each shareholder shall be entitled to have a specific item of business included on the agenda of shareholders' meetings, provided that such shareholder submits a written request to this effect to the Board of Directors of the Company with sufficient advance notice for the item to be included on the agenda.

#### Chairman of the Meeting

- 4.04 A chairman, elected at the meeting, shall preside over shareholders' meetings and appoint a secretary with the approval of the meeting. The Chairman shall resolve all issues relating to the validity of the meeting pursuant to these Articles of Association, decide the form of discussion, the treatment of issues at the meeting and voting procedures.

#### Minutes.

Minutes shall be kept of the meeting and all decisions of the meeting and the results of all polls shall be entered along with a concise account of proceedings. The Chairman and the secretary shall sign the minutes after they have been read and approved. The recorded minutes shall constitute conclusive proof of the proceedings of each shareholders' meeting.

The Annual General Meeting may establish special rules of order for shareholders' meetings.

#### Voting

- 4.05 At shareholders' meetings, each króna of share capital shall carry one vote.

Decisions at shareholders' meetings shall be taken by majority vote unless otherwise provided in these Articles or statutory law. Proposals are dismissed if they receive an equality of votes. In the event of an equality of votes, elections shall be decided by casting lots.

The consent of all shareholders is required to conclude the issues described in Article 94 of Act No. 2/1995 on Limited Liability Companies.

Voting shall be by ballot if any attendant so requests.

#### Right to Attend

- 4.06 Shareholders, shareholders' proxies, Company auditors and the CEO of the Company, even if he is not a shareholder in the Company, are entitled to attend shareholders' meetings. The Board of Directors may also invite experts to attend specific meetings if their opinion or assistance is required.

A shareholder must be registered in the share ledger of the Company at least eight days before the meeting to acquire voting rights. The attendance and voting rights of those present at a meeting shall be ascertained at the beginning of each meeting.

#### Agenda – documents of the meeting.

- 4.07 The final agenda, as well as all major proposals to be voted on at the shareholders' meetings, shall be laid open to all shareholders for inspection at the Company's office no later than seven days before the meeting.

Items which are not included on the agenda of a shareholders' meeting may not be brought to a conclusion at the meeting except with the consent of all the shareholders in the Company, but resolutions may be passed on such matters for the purpose of providing guidance to the Board of Directors.

Lawfully submitted proposals for amendments may be placed before the meeting itself even if they have not been laid open for inspection by shareholders.

The Company's accounts along with the Auditor's comments, the response from the Board of Directors and the Auditor's proposed conclusion shall be laid open for inspection by shareholders at the Company's offices no later than seven days before the Annual General Meeting.

### 5. The Board of Directors of the Company

- 5.01 The Board of Directors of the Company shall be composed of 6 (six) members elected at the Annual General Meeting.

Elections to the Board shall always be by ballot if the number of nominations exceeds the number of Members to be elected.

If shareholders holding at least 1/10 of the stock capital should so request, the Members of the Board shall be elected by proportional or multiple voting. Requests to this effect shall be delivered to the Board of Directors at least five days prior to the meeting.

#### Allocation of Tasks in the Board of Directors

- 5.02 The Board shall elect a Chairman from among its Members and allocate tasks among its members. The Board of Directors shall establish its own rules of procedure regarding the performance of its duties.

#### Calling of Meetings of the Board of Directors

The Chairman shall call meetings of the Board and preside at Board meetings. The Chairman shall ensure that all Members of the Board are notified. Meetings shall be held whenever the Chairman considers them necessary or when the CEO or any Member of the Board requests such a meeting.

#### Validity of Meetings of the Board of Directors

The presence of the majority of the members of the Board constitutes a quorum. Important decisions, however, may not be taken unless all members of the Board have had the opportunity, if possible, of discussing the matter.

A simple majority shall decide issues, unless otherwise provided in these Articles of Association or other lawful instructions. In the event of an equality of votes, the Chairman of the Board shall cast the deciding vote.

Members of the Board shall keep minutes of proceedings at meetings of the Board and confirm such minutes with their signatures.

- 5.03 The Board of Directors of the Company is the supreme authority in the affairs of the Company between shareholders' meetings.

The principal duties of the Board of Directors are the following:

1. To appoint a CEO and decide on his salary and the terms of his employment, establish his terms of reference and supervise his work.
2. To supervise continuously and precisely all aspects of the Company's operations and ensure that the Company's organisation and activities are always in good and proper order. In particular, the Board shall ensure adequate supervision of the accounts and disposal of the Company's property.
3. To represent the Company before the courts and government authorities.
4. To resolve differences of opinion as may arise between the CEO and other employees.
5. To decide who shall be authorised to bind the Company.
6. To resolve other issues, as the Board deems necessary at any given time.

- 5.04 The Board of Directors is responsible for the affairs of the Company between shareholders' meetings and their resolutions and contracts are binding for the Company. The signatures of a majority of the Members of the Board are required to bind the Company. Important decisions, such as the purchase or sale of property, may not be taken unless all Members of the Board have had the opportunity to discuss the matter. The same applies to major borrowings requiring mortgaging the Company's property.

### 6. The Chief Executive Officer

- 6.01 The Board of Directors shall appoint a CEO to manage the Company's daily operation.

The CEO of the Company is responsible for the day-to-day operation of the Company, pursuant to the rules established by the Board of Directors, or in accordance with the Company's Articles. The day-to-day operations do not include measures which are unusual or extraordinary. The CEO shall ensure that the accounts of the Company conform to the law and accepted practices and that the disposal of the property of the Company is secure.

- 6.02 The CEO of the Company is under obligation to follow all instructions of the Board of Directors. He/she is required to provide any information that may be requested by the Company's auditors. A member of the Board of Directors may be appointed CEO.

### 7. Accounts and Auditing

- 7.01 The fiscal year of the Company shall be the calendar year. Each fiscal year, the annual accounts of the Company shall be prepared, containing a profit and loss account, balance sheet, cash flow statement and notes.

- 7.02 One auditor which shall be an auditing firm shall be elected at the Annual General Meeting for a term of one year. The auditor, however, shall not be a member of the Board of Directors, CEO or employee of the Company.

The auditor shall examine the Company's annual accounts in accordance with generally accepted accounting principles, and shall for this purpose inspect account records and other material relating to the operation and financial position of the Company. The Auditor shall at all times have access to all books and documents of the Company.

The auditor shall have completed the audit of the Company's annual accounts no later than one month before the Annual General Meeting. He shall then send the audited accounts to the Board of Directors of the Company together with his comments.

No later than one week before the Annual General Meeting, the Board of Directors of the Company shall have prepared their responses to the Auditor's comments and the responses and comments shall be laid open for inspection by shareholders, together with the annual accounts, at least one week before the Meeting.

- 7.03 The annual accounts shall clearly and in detail state the income and costs of the Company, its assets and liabilities. The charges shall include reasonable depreciation of real estate and liquid assets of the Company.

#### **8. Own Shares Held by the Company**

- 8.01 The Company may own up to 10% – ten per cent – of its own shares. The Company may buy shares only pursuant to authorisation granted to the Board of Directors by a shareholders' meeting. Authorisation to the Board of Directors to buy Company shares shall not be valid for longer than 18 months at a time. No voting rights are attached to Company owned shares.

#### **9. Amendments to the Articles of the Company**

- 9.01 Amendments to the Articles of Association of the Company, other than those provided for in the Act on Limited Liability Companies, shall only be made at a valid shareholders' meeting. A decision to amend the Articles of Association is valid only if it has the support of at least 2/3 of the cast votes and the support of shareholders controlling at least 2/3 of the share capital represented at the meeting.

Proposals to reduce the share capital of the Company shall be treated as amendments to the Articles.

Notwithstanding the above, the terms of these Articles regarding voting rights of shareholders and equality among them may not be amended except with the consent of 9/10 – nine tenths – of all votes, cf. Article 94. of Act No. 2/1995 on Limited Liability Companies.

#### **10. Dissolution of the Company**

- 10.01 The dissolution of the Company shall be governed by the provisions of Chapter XIII of Act No. 2/1995 on Limited Liability Companies.

The same shall apply to any merger or joining of the Company with other companies and to the sale of all its assets. A shareholders' meeting that has made a valid decision to dissolve the Company shall also decide on the disposal of assets and the payment of debts, cf. Chapter XIII of Act No. 2/1995 on Limited Liability Companies.

#### **11. Further Provisions**

- 11.01 Matters on which these Articles provide no directions shall be governed by the provisions of Act No. 2/1995 on Limited Liability Companies.

(Intermediate headings within specific sections are not a part of these Articles of Association)

These Articles of Association were approved at a Shareholders' meeting on 2 November 1995

The following Shareholders' meetings have approved amendments to these Articles of Association:

Annual General Meeting 26 July 1996

Annual General Meeting 9 April 1999

Shareholders' Meeting 5 July 1999

Annual General Meeting 24 March 2000

Also amended at a meeting of the Board of Directors on 22 July 1999 when the Board exercised a part of the authorisation provided for in Paragraph 2, Section 2.01 for the increase of share capital by ISK 13,937,460 and part of the authorisation in Paragraph 3, Section 2.01 by ISK 38.000.000. The Articles of Association were also amended at a meeting held by the Board of Directors on 28 March 2000 when the Board exercised the authorisation in item A paragraph 4 Section 2.01 for the increase of share capital by ISK 60.000.000. Furthermore, at a meeting held by the Board of Directors on 30 June 2000, the Board utilised part of the authorisation for increased share capital according to paragraph 2. in Section 2.01 and at a meeting held by the Board of Directors on 27 October 2000, when the Board utilised part of the authorisation for increased share capital according to item 3. in Section 2.01 by ISK 4.912.435

Reykjavík, 27 October 2000

Pétur Guðmundarson,  
Chairman of the Board