Össur hf.

Consolidated financial statements

June 30th 2001

Össur hf.
Grjóthálsi 5
110 Reykjavík

kt. 560271-0189

Contents

Report by the Board of Directors and Managing director

It is the opinion of the Board of Directors and the President and CEO of Össur hf. that these Financial Statements present all the information necessary to show the position of the Company at June 30th 2001, the operational results for the period January 1st to June 30th 2001, and financial developments during that period.

The Board of Directors and President and CEO of Össur hf. hereby confirm the Consolidated Financial Statements of the Össur Group for the period January 1st to June 30th 2001 with their signatures.

Reykjavik, July 24th 2001

Board of Directors:

Pétur Guðmundarson
Chairman of the Board

Össur Kristinsson

Gunnar Stefánsson

Heimir Haraldsson

Kristján T. Ragnarsson

Sigurbjörn Þorkelsson

President and CEO

Jón Sigurðsson

Key figures

Consolidated statement

		30.6.2001	30.6.2000	2000	1999	1998
Growth						
Net sales in terms of 2001 prices	ISK millions	3.132,4	1.381,5	3.740,0	1.418,3	1.159,5
Net income before extraordinary exp. (2001 prices)	ISK millions	311,9	143,2	423,3	151,8	88,8
Total assets in terms of June 30th prices	ISK millions	5.794,8	3.860,1	5.065,5	1.932,5	595,5
EBITDA	ISK millions	435,7	178,6	726,7	264,9	
Operational performance						
Cash provided by operating activities (2001 prices)	ISK millions	380,0	12,4	473,1	255,7	90,4
- as ratio to total debt	%	26,9	4,0	30,0	67,0	24,5
- as ratio to income		1,2	0,1	1,1	1,7	1,0
Working capital from operating activit. (2001 prices)	ISK millions	407,0	252,1	689,3	204,9	128,5
- as ratio to long-term debt and stockholders´equity	%	21,5	20,7	24,6	19,2	30,9
- as ratio to investment, current maturities, dividends		0,4	0,0	0,1	2,7	2,4
Liquidity and solvency						
Acid-test ratio		1,2	1,0	1,1	1,5	1,7
Current ratio		1,7	1,5	1,5	2,2	2,7
Equity ratio	%	50,1	44,8	44,6	78,6	35,7
Asset utilization and efficiency						
Total assets turnover		1,2	1,0	1,1	1,1	2,2
Grace period granted	Days	45	101	50	40	39
Profitability						
Return on total assets	%	17,5	15,0	8,2	22,9	22,2
Return on common equity	%	25,1	11,8	9,0	44,7	77,3
Operating profit as ratio to net sales	%	10,8	13,3	16,5	16,1	14,7
Net income before taxes as ratio to net sales	%	10,3	14,1	12,9	16,6	12,5
Net income for the year as ratio to net sales	%	9,9	10,4	11,3	10,7	7,7
Market						
Year-end market value	ISK millions	15.467,6	19.128,0	21.677,1	8.477,5	
Price/earnings ratio		24,8	69,8	53,0	60,8	
Price/book ratio		5,3	11,8	10,1	6,1	
Number of shares	Millions	328,4	277,2	328,4	211,9	
Profit per share	ISK	1,9	1,0	1,3	0,7	

* Key figures for the year 2000 have been calculated using net income before extraordinary expenses.
** Key figures have been calculated as for a 12 month period.

Auditor’s Report

To the Board of Directors and Shareholders of Össur hf.

We have reviewed the accompanying Consolidated Balance Sheet of Össur hf. and subsidiaries as of June 30th 2001, and the related Consolidated Statement of Income and Cash Flows for the period then ended. These interim Consolidated Financial Statements contain Income statement, Balance sheet, Statement of Cash Flows and Notes to the Financial Statements. These Financial Statements are the responsibility of the Company’s management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with generally accepted auditing standards applicable to review engagements. Those standards require that we plan and perform the review to obtain moderate assurance as to whether the Financial Statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review nothing has come to our attention that causes us to belive that the accompanying Financial Statements do not give a true and fair view of the financial position of Össur hf and subsidiaries as of June 30, 2001, of the results of their operations and their cash flows for the period than ended in accordance with generally accepted accounting principles applied on a consistent basis. Financial statements of foreign subsidiaries have been reviewed by Deloitte & Touche in the countries where they are located.

Reykjavík, July 24th 2001

Deloitte & Touche

Heimir Þorsteinsson	Sif Einarsdóttir
State Authorized Public Accountant	State Authorized Public Accountant

Income Statement for January 1st to June 30th 2001

	Notes	1/1-30/6 01	1/4-30/6 01	1/1-30/6 00
		Consolidated statement		
Operating revenues				
Net sales and other income		3.132,4	1.711,7	1.321,7
		3.132,4	1.711,7	1.321,7
Operating expenses				
Cost of goods sold		1.246,8	704,5	525,8
Sales and marketing expenses		601,2	313,6	250,3
Research and development expenses		256,0	156,1	101,8
General and administrative expenses		691,0	345,7	269,9
		2.794,9	1.519,8	1.147,8
Operating profit		337,5	191,9	173,9
Net interest				
Interest income (expenses)	15	(13,8)	17,3	10,5
Income before taxes		323,8	209,3	184,4
Taxes				
Income tax	14	(14,9)	44,0	(48,9)
Net income before income in affiliated companies		308,9	253,3	135,4
Affiliated companies				
Share of income in affiliated companies		3,0	2,2	0,0
Net income before extraordinary expenses		311,9	255,5	135,4
Extraordinary expenses				
Goodwill charged to cost		0,0	0,0	(3.688,1)
Net income/(loss) for the period		311,9	255,5	(3.552,6)

All amounts in millions of ISK 5

Balance Sheet

Assets

	Notes	Consolidated statement 30. 6. 2001	31. 12. 2000
Fixed assets			
Intangible assets			
Goodwill/deferred tax asset	4	2.253,1	1.751,8
Other intangible assets	5	34,1	32,9
		2.287,2	1.784,7
Operating fixed assets	6		
Buildings and sites		291,6	233,1
Other operating fixed assets		568,5	437,7
		860,1	670,9
Investments			
Share of equity in affiliated companies		13,9	0,0
Long-term securities	7	146,4	158,5
		160,3	158,5
Total fixed assets		3.307,6	2.614,1
Current assets			
Inventories	8		
Raw materials and work in process		315,8	258,6
Finished products		411,0	354,3
		726,9	612,9
Short-term receivables			
Accounts receivable	9	1.073,6	875,5
Other receivables	10	159,9	109,4
		1.233,6	984,9
Cash and cash equivalents			
Marketable securities	11	132,4	265,2
Cash		394,4	338,1
		526,8	603,4
Total current assets		2.487,3	2.201,2
Total assets		5.794,8	4.815,3

All amounts in millions of ISK

Liabilities and equity

	Notes	Consolidated statement 30. 6. 2001	31. 12. 2000
Stockholders' Equity	12		
Common stock		328,4	328,4
Additional paid-in capital		7.660,6	7.660,6
Statutory reserve		15,2	15,2
Other equity (negative)		(5.102,1)	(5.942,9)
Total stockholders´equity		2.902,1	2.061,3
Liabilities			
Long-term liabilities	13		
Credit institutions		1.415,3	1.293,7
Long-term notes		95,1	91,2
Other long-term liabilities		504,2	557,4
		2.014,7	1.942,3
Current maturities of long-term debt		(569,5)	(770,3)
Total long-term liabilities		1.445,1	1.172,0
Current liabilities			
Accounts payable		252,6	290,1
Current maturities, as above		569,5	770,3
Accrued taxes payable	14	7,3	11,2
Other current liabilities		361,1	266,2
Accrued salaries, and other expenses payable		257,1	244,3
Total current liabilities		1.447,6	1.582,0
Total liabilities		2.892,7	2.754,0
Total liabilities and stockholders´equity		5.794,8	4.815,3

All amounts in millions of ISK 7

Statement of Cash Flows January 1st to June 30th 2001

	Notes	Consolidated statement 6 m 2001	2000
Cash flows from operating activities			
Net income/(loss) for the period		311,9	(3.552,6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities			
Depreciation and amortization	5,6	98,2	39,9
Other non-cash items		6,8	13,5
Deferred income tax		(6,9)	48,9
Goodwill charged to cost		0,0	3.688,1
Share of income in affiliated companies		(3,0)	0,0
Working capital from operating activities		407,0	237,8
Changes in operating assets and liabilities			
Inventories, increase		10,7	(34,9)
Accounts receivable, increase		(1.008,9)	(124,6)
Current liabilities, (decrease) increase		971,2	(70,0)
Net cash provided by operating activities		380,0	8,4
Cash flows from investing activities			
Purchase price of fixed assets		(156,6)	(5.742,7)
Sales price of fixed assets		9,5	15,0
Share investments		(69,1)	0,0
Long-term securities and other receivables		(5,6)	925,0
Net cash used in investing activities		(221,8)	(4.802,7)
Cash flows from financing activities			
Borrowings of long-term debt		1.391,1	5.772,1
Maturities on long-term debt		(1.678,6)	(4.600,8)
Paid-in capital		0,0	3.713,9
Net cash provided by financing activities		(287,4)	4.885,3
Net increase in cash and cash equivalents		(129,2)	91,0
Effects of foreign exchange adjustments		52,7	3,5
Cash and cash equivalents at beginning of year		603,4	120,4
Cash and cash equivalents at end of period		526,8	214,9

Notes: Statement of cash flows 16

All amounts in millions of ISK 8

Notes to the Financial Statements

Operations

Össur hf. designs, manufactures and sells prosthetics solutions. The Company's main products are sockets, prosthetic feet, prosthetic knees and various components used in the manufacturing of prosthetic limbs. The Company's main markets are North America, Western Europe and Japan. In addition to the Parent Company in Iceland, the Company operates in the USA, Sweden, the Netherlands and the UK. The biggest portion of the manufacturing is performed by Flex-Foot, Inc., in Aliso Viejo, California where assembly and distribution of the Company's products to prosthetics workshops and distributors all over the world takes place. The Company's other locations in the USA are Mauch, Inc., located in Daytona, Ohio, where artificial knees are manufactured, and Century XII Innovations, Inc. in Albion, Michigan, where artificial knees are designed and manufactured. Companies are operated in Sweden selling and distributing the Company's products in Scandinavia and Baltic countries. One of the companies also manufactures and sells products for the so-called auxiliary aids industry. In Iceland the Company operates a prosthetics workshop and a prosthetics store, as well as manufacturing sockets and components for export.

Summary of Accounting Policies

1. The Financial Statements of the Össur Group have been prepared in accordance with the Act on Financial Statements and generally accepted accounting standards in Iceland. They have been prepared, for the most part, in accordance with the same accounting principles as for the preceding year. Changes in accounting principles are explained in note 2.

The Financial Statements of the Icelandic companies within the Group have been prepared using historical cost accounting, adjusted for the effects of general price level changes. Operating results are presented at the average price level and amounts in the Balance Sheet at the period-end price level. The adjustment is based on a 5.2% increase in the Official Consumer Price Index during the period. The net book value of fixed assets and intangible assets has been revalued by restating the cost and depreciation to the end of the period. Fixed assets and intangible assets added or sold during the period have been revalued based on term of ownership. The effect of general price level changes on monetary assets and liabilities at the beginning of the year, as well as their changes during the period, have been calculated and entered as income amounting to ISK 56,9 million. Revaluation of fixed assets and the calculated inflation adjustment have been posted to the revaluation reserve account in the Balance Sheet under Stockholders' Equity. Monetary assets and liabilities indexed or denominated in foreign currencies are presented at year-end price level or at the period-end exchange rate.

The Financial Statements of other companies within the Group have been prepared using historical cost accounting. Operational items are presented in Icelandic currency (ISK) at the average price level for the period, and Balance Sheet items are presented in ISK at the period-end exchange rate.

Other accounting policies relating to individual items in the Financial Statements are specified in the following notes.

Comparison To The Previous Year

2. Comparison figures from the preceding year are not adjusted to 2001 price levels. Substantial changes were made in the operation of the Group over the year 2000, with investments in new companies taking place in April, late October and late November. The operating figures for the first six months of the year 2000 show only three months of the operation of the FlexFoot Group. The Scandinavian group and Century group are included for the first time in October and November 2000. In the profit and loss account of Össur for the first six months of 2001, all subsidiaries are in full operation.

The following changes have been made in accounting principles from prior year:

On the basis of IAS 39, the exchange-rate difference of a foreign loan taken to finance the acquisition of US subsidiaries is entered to equity against the exchange-rate adjustment of the operation and assets of the subsidiaries, since the loan was taken as a hedge against net investment in a foreign entity. The exchange-rate loss, net of taxes and purchasing power gain, is ISK 120.4 million.

In the Group's Statement of Cash Flows, the effects of foreign exchange adjustment of the cash flow statements of foreign subsidiaries is shown as a separate reconciliation item, in accordance with IAS 7. Comparison figures from the the first six months of the year 2000 have been changed correspondingly.

Comparison figures from the 2000 Financial Statements have been adjusted for the acquisition of subsidiaries in late 2000. Expenses appeared in the course of finalisation of contracts, which formed a part of the investment cost in respect of the subsidiaries, and should have been charged to extraordinary expenses as depreciation of goodwill in the Financial Statements for 2000. As a result, current liabilities as at December 31, 2000 have been increased by ISK 84.2 million.

The Group

3. The Consolidated Financial Statements of the Össur Group pertain to the following subsidiaries:

	Ownership
J. Bergström Förvaltnings, AB	100%
Karlsson & Bergström, AB	100%
Karlsson & Bergström, AS	100%
Mega Hali Med, AB	100%
PI Medical, AB	100%
PI Medical, ApS	100%
PI Protesindustri, AB	100%
Protese Industri Medical, AS	100%
Össur Holdings, Inc.	100%
Century XXII Innovations, Inc.	100%
Century XXII Engineering, Inc.	100%
Flex Foot, Inc.	100%
Mauch, Inc.	100%
Össur USA, Inc.	100%
Össur Holding, S.a.r.l.	100%
OR Capital, Inc.	100%
Össur stoðtæki hf.	90%
Össur UK, Ltd.	100%

At the beginning of the year Össur hf. participated in the establishment of Eirberg ehf. among others. Össur hf. ownes 50% of the shares and they are recorded by equity method.

The Consolidated Financial Statements have been prepared in conformity with the cost method of accounting. When ownership in subsidiaries is less than 100%, the minority interest in stockholders' equity and performance is written up. The minority interest in Össur stoðtæki hf. is minimal and is not recorded separately in the Financial Statements.

One of the purposes of Consolidated Financial Statements 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 the calculated income taxes of the Group adjusted accordingly.

Intangible Assets

4. **Goodwill/calculated tax asset** are explained, on the one hand, by taxable benefits relating to the purchase of shares in other companies in excess of the recorded book value of their stockholders' equity and, on the other hand, by calculated tax credit due to operational loss. Tax liabilities of some of the subsidiaries are deducted from the calculated tax credit. The amount is further specified as follows in millions of ISK:

Taxable benefits in relation to the purchase of shares in other companies	1.930,9
Calculated tax credit because of carry-forward loss	324,4
Calculated tax credit because of eliminated gain in inventories within the Group	41,7
Tax liabilities	(43,9)
	2.253,1

According to the tax law in force in California, the purchase price of shares in excess of the book value of stockholders' equity is deductible over a period of 15 years if the purchase complies with specified conditions. Thus the subsidiary Össur Holdings Inc. will not have to pay taxes for the next 14 years on profits amounting to ISK 6,156 million. The Company's plans estimate sufficient annual profits to make use of the taxable benefits; thus 30% of the amount has been capitalized, despite the fact that the tax percentage in California is closer to 40%. The amount will be charged as income tax in the Statement of Earnings over the next 14 years. Accordingly, ISK 59.5 million was charged as income tax in the Statement of Income for the period ended 30th of June, and the remaining balance amounts to ISK 1,930.9 million.

At the 30th of June 2001 the Group had a carry-forward loss, which can be used in following years. The calculated taxable benefits thereof, 30% of the carry-forward loss or ISK 324.4 million, have been capitalized. This is offset by the tax liabilities of the Group, which are estimated to be paid over the next few years; calculated tax liabilities amounting to ISK 43.9 million are deducted from the calculated tax credit.

In preparing the Consolidated Financial Statements, accumulated gains in inventories resulting from intergroup transactions amounting to ISK 139 million were eliminated. This results in an overstatement of the calculated income tax of the Group, and an adjustment of ISK 41.7 million is made in the Consolidated Financial Statements to account for this.

5. **Other intangible assets** include, on the one hand, capitalized development expenses of previous years and, on the other hand, the cost of obtaining patents for the products manufactured by the Company. These assets are amortized by 10-20% annually. All development costs incurred during the period are expensed.

Development cost and other intangible assets are further specified as follows in millions of ISK:

Cost at January 1.	63,3
Previosly amortized	(30,4)
Book value at January 1.	32,9
Revaluation and exchange rate difference during the period	5,6
Addition during the period, cost	0,9
Amortized during the period	(5,2)
Book value at June 30.	34,1

The amortization of other intangible assets, classified by operational category, are specified as follows in millions of ISK:

Development expenses..	3,0
General and administrative expenses..	2,2
	5,2

Fixed Assets and Depreciation

6. Depreciation of fixed assets is calculated on a straight-line basis. The amounts recorded are based on the restated historical cost at June 30. The following rates are used:

Real estate	2,5-10%
Automobiles	4-20%
Machinery and equipment	12-50%
Fixtures and office equipment	10-44%

Fixed assets, revaluation and depreciation are specified as follows in millions of ISK:

	Buildings and sites	Automobiles	Machinery & equipment	ixtures & office equipment	Total
Total value January 1.	258,0	20,3	516,1	290,8	1.085,2
Previously depreciated	(24,9)	(5,4)	(253,0)	(131,0)	(414,3)
Net book value January 1.	233,1	14,9	263,1	159,8	670,9
Revaluation / exchange rate differ. during the period	55,4	2,3	49,2	29,0	135,9
Purchases dur. the period	9,3	15,7	81,8	56,8	163,5
Sales during the period	0,0	(4,0)	(12,8)	(0,5)	(17,3)
Depr. during the period	(6,3)	(1,9)	(46,1)	(38,7)	(93,0)
Net book value June 30.	291,5	26,9	335,2	206,4	860,1

Depreciation is calculated as a fixed annual percentage of revalued cost price, based on the ownership during the period. It is charged off to expenses at the average price level for the period. Depreciation, classified by operational category, is specified as follows in millions of ISK:

Cost of goods sold	35,2
Sales and marketing expenses	3,8
Research and development expenses	10,8
General and administrative expenses	43,2
	93,0

Investments

7. Long-term securities are intended for the future growth and expansion of the Group. Long- term securities are recorded at purchase price adjusted due to price level changes and are specified as follows in millions of ISK:

Notes and bonds	41,7
Shares held in trust	14,2
Mutual funds	44,9
Other long-term securities	45,6
	146,4

Notes to the Financial Statements

Inventories

8. Inventories are valued at cost/manufacturing cost or market value, whichever is lower, after taking into consideration obsolete and defective goods.

Finished products have been reduced in the Consolidated Financial Statements by unrealized gain from intergroup transactions.

Short-term Receivables

9. Accounts receivable are valued at cost plus incurred interest and exchange rate difference, less a provision for doubtful receivables amounting to ISK 45.8 million. This provision is deducted from the appropriate Balance Sheet items and does not represent a final write-off.

10. Other receivables are specified as follows in millions of ISK:

Value added tax, refund	37,1
Prepaid expenses and miscellaneous	122,8
	159,9

Marketable Securities

11. Marketable securities consist of mutual fund shares and are valued at the period-end exchange rate. The securities are readily accessible.

Stockholders' equity

12. Changes in Stockholders' equity are as follows:

	Common stock	Additional paid-in capital	Statutory reserve	Other Equity	Total
Stockholders' equity as of January 1,	328,4	7.660,6	15,2	(5.942,9)	2.061,3
Tax impact of prior period adjustment.........................				9,4	9,4
Revaluation of fixed assets				8,2	8,2
Translation difference of shares in foreign comp.......				568,2	568,2
Calculated infl. adjustm.....				(56,9)	(56,9)
Profit for the period				311,9	311,9
	328,4	7.660,6	15,2	(5.102,1)	2.902,1

Issued shares at period-end numbered a total of 328,441,000. The nominal value of each share is ISK 1.

Long-term Debts

13. Long-term debts are recorded in terms of the period-end price level. Long-term debts, classified by currency, are specified as follows in millions of ISK:

	Remaining balance
Long-term debts in foreign currencies:	
Loans in USD	1.707,8
Loans in SEK	18,4
Loans in JPY	0,7
	1.726,9
Loans in ISK	287,8
	2.014,7

Notes to the Financial Statements

Taxation

14. Taxes on the Group's profits during the period have been calculated and entered into the Consolidated Financial Statements. Charged income tax in the Income Statement is further specified as follows in millions of ISK:

	1.1.-30.6.2001	1.4.-30.6.2001
Income tax payable in the period	7,3	(13,9)
Amortized taxable benefits relating to the purchase of other companies	61,7	32,9
Income tax effects of the elimination of unrealized inventory gains	(6,6)	(7,5)
Changes in calculated tax benefits / tax liabilities in the year 2000	(47,5)	(55,5)
	14,9	(44,0)

Other Issues

15. Financial income and (financial expenses) are specified as follows in millions of ISK:

	1.1.-30.6.2001	1.4.-30.6.2001	1.1.-30.6.2000
Interest income	18,5	9,2	61,3
Dividends	0,0	0,0	0,0
	18,5	9,2	61,3
Interest expenses and exchange rate difference	(89,2)	(26,6)	(21,6)
General price level gain (loss)	56,9	34,7	(29,2)
	(13,8)	17,3	10,5

Cash flow

16. Net cash provided by operating activities and working capital provided by operating activities in the comparison figures relate only to the regular operations of the Group, as the operational results have been fully adjusted for depreciated goodwill because of the acquisition of other companies.

Changes in operational assets and liabilities in the comparison figures are calculated from the date of acquisition of the companies until year-end, but otherwise from the beginning of the year until year-end 2000. Cash and cash equivalents in acquired companies are recorded as a separate item in the Statement of Cash Flows.

The treatment of effects of foreign exchange adjustments in the Statement of Cash flows is explained in Note 2.

Other calculated items in the operational activities are specified as follows:

	1.1.-30.6.2001	1.1.-30.6.2000
Indexation and exchange rate differences on assets and liabilities	64,3	(13,9)
Calculated inflation adjustment	(56,9)	29,2
Gains from sales in excess of loss from sales	(0,6)	(1,8)
	6,8	13,5