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Directors' report

Total revenues amounted to 1.034 million ISK in 1998 as compared with 783 million ISK in the previous year. That equals an increase of 251 million ISK.

Income before taxes was 128,9 million ISK in 1998, as compared with 31 million ISK in 1997.

In 1998 approximately 83 employees worked fulltime for the parent company compared to 65 in the previous year. Total salaries and wages amounted to 214,7 million ISK. Employees working for the subsidiary companies were 18 in 1998 as compared with 22 in 1997.

Shareholders were 7 in number at the end of 1998 and one shareholder owns more than 10% of outstanding shares. Össur Kristinsson owns 88%.

Net income for the year amounted to 79,1 million ISK. The board of directors proposes no dividend to be paid to shareholders for 1998.

The board of directors and the general manager of the company confirm the financial statements with their endorsement.

Reykjavík, March 31st 1999.

Board members:

Pétur Guðmundarson,
chairman

Össur Kristinsson

Gunnar Stefánsson

Þorkell Sigurlaugsson

Jón Sigurðsson,
general manager

Key figures

		1998	1997	1996
Growth				
Net sales in terms of 1998 prices	ISK ’000	1.033.528	797.182	616.399
Employees	Number	101	87	67
Net income in terms of 1998 prices	ISK ’000	79.113	11.532	6.066
Total assets in terms of 1998 year end prices	ISK ’000	514.578	450.332	431.188
Operational performance				
Cash provided by operations in terms of 1998 prices	ISK ’000	80.569	33.020	-36.802
- as ratio to total debt	%	24,5	10,0	-11,3
- as ratio to income		1,0	2.9	-6,1
Working capital from operations in terms of 1998 prices	ISK ’000	117.806	40.044	20.498
- as ratio to long-term debt and owners´ equity	%	31,8	11,9	6,2
- as ratio to investment, current maturities and dividend	%	211,1	70,8	32,7
Liquidity and solvency				
Acid-test ratio		1,7	1,3	1,2
Current ratio		2,7	2,3	2,3
Equity ratio	%	35,7	23,2	23,9
Asset utilization and efficiency				
Net sales pr. employee in terms of 1998 prices	ISK ’000	10.233	9.163	9.200
Total assets turnover	Frequency	2,2	1,8	1,7
Inventory turnover, raw materials	Frequency	5,9	5,3	4,2
Inventory turnover, finished products	Frequency	6,3	6,0	5,5
Days’ sales in receivables	Days	40	41	44
Profitability				
Return on total assets	%	22,2	4,6	5,0
Return on common equity	%	77,3	12,8	4,5
Operating profit as ratio to net sales	%	14,7	5,0	7,0
Net income before taxes as ratio to net sales	%	12,5	4,0	5,1
Net income for the year as ratio to net sales	%	7,7	1,4	0,9

Auditors' report

We have audited the accompanying balance sheet of the parent company Össur hf. (Ltd.) and the consolidated financial statements of Össur Ltd. and its subsidiaries as of December 31st. 1998, and the related statements of income and cash flows for the year then ended. The financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of foreign subsidiaries are audited by other auditors and they have all expressed an unqualified opinion on these financial statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our own audit and the unqualified audit reports on foreign subsidiaries, the financial statements present fairly, in all material respects, the financial position of the company as of December 31st. 1998, the results of its operations and cash flows for the year then ended in accordance with generally accepted principles of accounting.

Kopavogur, March 31st 1999.

L. E. Ltd. representing
ANDERSEN WORLDWIDE SC

Stefán Svavarsson,
Árni Tómasson,

State Authorized Accountants

Income statement for 1998

	Note	Consolidated statement 1998	Consolidated statement 1997	Parent company 1998	Parent company 1997
Operating revenues					
Net sales		998.331.857	779.868.190	818.566.310	506.230.579
Other income		35.196.316	3.616.887	35.196.316	88.917.705
Operating revenues		1.033.528.173	783.485.077	853.762.626	595.148.284
Operating expenses					
Cost of materials used		219.605.468	213.969.896	227.213.070	179.579.505
Salaries and related expenses		308.834.362	237.376.427	230.474.066	174.095.639
Research and development costs	4	49.158.591	52.539.393	54.925.963	52.539.393
Other operating expenses		276.123.792	215.964.495	183.697.549	142.437.574
Depreciation	5	27.899.770	24.100.173	21.549.766	17.373.622
Operating expenses		881.621.983	743.950.384	717.860.414	566.025.733
Operating profit		151.906.190	39.534.693	135.902.212	29.122.551
Net interest costs					
Interest income		1.693.194	1.955.575	1.353.149	1.293.039
Interest expenses and exchange rate losses		(24.745.139)	(10.648.621)	(23.476.163)	(9.334.274)
Gain (loss) on net monetary position	3	23.374	121.061	1.047	(27.545)
Net interest costs		(23.028.571)	(8.571.985)	(22.121.967)	(8.068.780)
Income before taxes		128.877.619	30.962.708	113.780.245	21.053.771
Taxes					
Income tax	15	(38.055.575)	(12.368.873)	(37.776.945)	(7.349.021)
Net worth tax		(2.476.070)	(1.023.815)	(2.471.162)	(1.023.815)
Net income before minority interests /subsidiaries		88.345.974	17.570.020	73.532.138	12.680.935
Minority interests and subsidiaries					
Intercompany investment income	6,15	0	0	13.665.307	3.952.244
Minority interest in net income	2	(1.148.529)	(936.841)	0	0
Net income before extraordinary items		87.197.445	16.633.179	87.197.445	16.633.179
Extraordinary expenses					
Royalties	21	(8.084.073)	(5.299.660)	(8.084.073)	(5.299.660)
Net income for the year		79.113.372	11.333.519	79.113.372	11.333.519

Balance Sheet

Assets

	Note	Consolidated statement 1998	Consolidated statement 1997	Parent company 1998	Parent company 1997
Fixed assets					
Intangible assets:	4				
Research costs		16.165.088	24.047.772	16.050.211	21.131.906
Patent		3.272.820	0	3.272.820	0
		19.437.908	24.047.772	19.323.031	21.131.906
Operating fixed assets:	5				
Machinery and equipment		33.153.840	49.044.740	29.423.621	37.855.791
Fixtures and furniture		55.560.364	35.066.427	41.478.624	26.779.216
Automobiles		12.663.422	14.398.009	10.575.567	10.876.502
Buildings and sites		11.807.876	23.261.341	11.807.876	23.261.341
		113.185.502	121.770.517	93.285.688	98.772.850
Long-term investments:					
Loans to subsidiaries	7	0	0	180.900.121	159.124.623
Share investments	6	33.784	33.784	(929.151)	(14.845.037)
Bonds		2.994.394	7.400.000	5.837.393	7.400.000
Current maturities on long-term bonds		(240.121)	(5.500.000)	(240.121)	(5.500.000)
		2.788.057	1.933.784	185.568.242	146.179.586
Total fixed assets		135.411.467	147.752.073	298.176.961	266.084.342
Current assets					
Inventories:	8				
Raw materials and goods in process		36.992.554	37.144.972	36.363.533	27.078.108
Finished products		103.145.541	91.846.386	59.500.556	46.202.251
		140.138.095	128.991.358	95.864.089	73.280.359
Short-term claims:					
Accounts receivables	9	128.120.082	91.853.880	32.075.169	28.337.601
Other receivables	10	27.702.036	21.187.633	14.527.286	21.008.698
		155.822.118	113.041.513	46.602.455	49.346.299
Liquid funds:					
Marketable securities	11	24.270.598	11.007.619	24.270.598	11.007.619
Cash		58.935.575	43.901.377	27.587.058	10.226.694
		83.206.173	54.908.996	51.857.656	21.234.313
Total current assets		379.166.386	296.941.867	194.324.200	143.860.971
Total assets		514.577.853	444.693.940	492.501.161	409.945.313

Liabilities and equity

	Note	Consolidated statement 1998	Consolidated statement 1997	Parent company 1998	Parent company 1997
Equity	12				
Share capital		4.882.500	4.882.500	4.882.500	4.882.500
General legal reserve		1.220.625	1.220.625	1.220.625	1.220.625
Retained earnings		177.735.464	96.849.789	177.735.464	96.849.789
Total owners' equity		183.838.589	102.952.914	183.838.589	102.952.914
Minority interest in net equity (negat.)	2	(223.985)	(1.390.925)	0	0
Tax liabilities					
Deferred income tax	13	6.254.885	9.517.562	13.109.678	9.517.562
Liabilities					
Long-term liabilities:	14				
Bank of Iceland, bond payable		92.500.319	106.893.472	92.500.319	103.116.065
Bearer bonds		77.141.657	76.175.812	77.141.657	76.175.812
Other long-term bonds		38.539.165	49.421.219	35.173.446	49.421.219
		208.181.141	232.490.503	204.815.422	228.713.096
Current maturities of long-term debt		(26.523.871)	(26.935.827)	(24.588.460)	(23.785.562)
Long-term liabilities		181.657.270	205.554.676	180.226.962	204.927.534
Current liabilities:					
Current maturities, as above	14	26.523.871	26.935.827	24.588.460	23.785.562
Accrued taxes payable	15	37.954.142	9.573.134	33.930.389	5.087.683
Other current liabilities		10.109.162	6.631.843	1.502.834	2.033.676
Accrued salaries, and other exp. payable.		27.506.159	34.333.461	22.866.512	18.572.570
Accounts payable		40.957.760	50.585.449	32.437.737	43.067.812
Current liabilities		143.051.094	128.059.714	115.325.932	92.547.303
Total liabilities		324.708.364	333.614.390	295.552.894	297.474.837
Liabilities and owners' equity		514.577.853	444.693.940	492.501.161	409.945.313

Statement of cash flows 1998

	Note	Consolidated statement 1998	Consolidated statement 1997	Parent company 1998	Parent company 1997
Operating activities					
Net income for the year		79.113.372	11.333.519	79.113.372	11.333.519
Reconciling items not involving cash:					
Depreciation		33.249.840	29.383.149	26.899.836	22.656.598
Loss on sale of operating fixed assets		1.054.026	(463.061)	319.428	(349.648)
Gain on net monetary position		(23.374)	(121.061)	(1.047)	27.545
Indexation and exchange rate difference on long-term debt		3.263.665	(1.712.955)	3.408.292	(1.773.680)
Intercompany investment income		0	0	(13.665.307)	(5.898.870)
Minority interest in net income		1.148.529	936.841	0	0
Working capital from operations		117.806.058	39.356.432	96.074.574	25.995.464
Changes in operating assets and liabilities					
Accounts receivable (increase) decrease		(36.266.202)	(6.210.737)	(25.513.066)	(11.951.698)
Other short-term assets (increase) deccrease		6.638.049	(292.396)	1.224.533	(3.025.233)
Inventories (increase) decrease		(11.146.737)	985.088	(22.583.730)	(2.738.275)
Current liabilities (decrease) increase		(11.757.047)	(7.095.767)	(6.866.975)	6.632.590
Taxes paid		(9.573.134)	(6.960.194)	(5.087.683)	(5.825.916)
Taxes expensed		24.867.895	12.670.935	37.522.505	8.185.484
Cash provided by operations		80.568.882	32.453.361	74.770.158	17.272.416
Investment activities					
Equipment		(6.960.826)	(16.580.521)	(2.334.197)	(13.671.964)
Automobiles		(1.751.000)	(6.052.882)	(1.751.000)	(4.000.000)
Sales price of fixed assets		14.370.105	6.352.124	11.650.000	1.649.952
Share investments		0	0	0	(14.260.922)
Bond debentures		4.405.606	0	1.559.590	0
Fixtures and furnitures, office equipment		(21.874.217)	(15.723.509)	(21.874.217)	(13.177.386)
Patent		(4.091.025)	0	(4.091.025)	0
Investment activities		(15.901.357)	(32.004.788)	(16.840.849)	(43.460.320)
Financing activities					
New long-term debt		3.536.838	43.984.344	3.536.838	40.234.344
Maturities on long-term debt		(38.686.561)	(23.274.773)	(30.842.804)	(23.135.884)
Increase (decrease) in bank overdraft		0	(9.463.920)	0	0
Cash dividends		(1.220.625)	(341.775)	0	(341.775)
Financing activities		(36.370.348)	10.903.876	(27.305.966)	16.756.685
Change in cash position		28.297.177	11.352.449	30.623.343	(9.431.219)
Cash - beginning balance		54.908.996	43.556.547	21.234.313	30.665.532
Cash - closing balance		83.206.173	54.908.996	51.857.656	21.234.313

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 Note nr. 3. The inflation in Iceland in 1998 was 1,27% and between the year 1997 and 1998 it was 1,75%. Comparative figures for 1997 have not been adjusted to 1998 prices.

2. *Consolidation*

The consolidated financial statements pertain to the following subsidiaries:

	Ownership share
Össur USA	100%
Össur Lux.	100%
Össur stodtaeki hf. (Ltd.)	90%
Össur UK	85%

The consolidated financial statements are prepared in conformity with the purchase method of accounting; the minority interest stems from Össur UK and Össur stodtaeki hf. (Ltd). 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. *Effects of general price changes*

The effects of general price level changes are calculated and included in the financial statements. The calculation is based on rules in the tax law. The main features of this accounting system are the following:

- The cost price of fixed assets is annually restated for the effects of changes in general prices. No restatement is, however, performed for fixed assets purchased in the year of reporting but on the other hand the cost price of fixed assets sold is restated fully during the year of sale of such assets for the purposes of calculating gain / loss on the sale of such assets.
- The effects of general inflation on monetary assets and liabilities are calculated and recorded in the financial statements. Additionally, a correction for the effects of inflation on the cost of goods sold is recorded in the statements. The calculation of these corrections is based on the net monetary position as well as the inventory level at the beginning of the year. During 1998 the construction cost index, representing general pricel changes, rose by 1.27%. Since the net monetary position including inventories was slightly negative at the end of 1997, a net credit entry of 23.374 ISK is included in the calculation of profits. The purpose is to show the net real interest cost corrected for the effects of inflation. The counterbalancing entry is to the revaluation account under owners' equity.
- Financial assets and liabilities linked to a local index are stated in terms of the price level at year-end. Financial assets and liabilities denominated in foreign currencies are recorded in terms of the exchange rate prevailing at the end of the year. The counterbalancing entries are included in the section on interest charges in the income statement.

Notes to the financial statements

4. ***Intangible assets***

In 1996 a research and development cost of 25.9 million ISK was capitalized. The amount is revaluated and expensed on a straight line basis during a period of five years. In 1998 ISK 5.3 million was expensed as research and development costs. All incurred research- and development costs in 1998 are expensed.

Patent cost of 4,1 million ISK was capitalized for the company´ products in 1998. The amount is revalued and will be expensed on straight line basis during a period of five years.

Fixed assets

5. 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:

Buildings	4%
Equipment	15%
Automobiles	8 – 15%
Machinery	12%
Fixtures	10%

- The fixed assets of the company consist of the following (ISK´000):

	Machinery	Fixtures	Equipment	Automobiles	Sites / Buildings	Total
Restated cost at Jan 1st	85.886	13.177	24.787	15.028	30.809	169.687
Restatement in 1998	1.091	168	315	190	391	2.155
Investment in 1998	2.334	13.668	8.194	5.171	0	29.367
Retired / sold	0	0	(974)	(5.056)	(13.927)	(19.957)
	89.311	27.013	32.322	15.333	17.273	181.252
Accum.depr. at Jan 1st	48.030	1.317	14.920	4.151	7.548	75.966
Restatement in 1998	610	18	113	853	95	1.689
Depreciation in 1998	11.247	2.701	4.814	1.362	607	20.731
Retired / sold	0	0	(6.026)	(1.608)	(2.785)	(10.419)
	59.887	4.036	13.821	4.758	5.465	87.967
Book value	29.424	22.977	18.501	10.575	11.808	93.285
Fixed assets of subsidiary companies						19.900
						113.185

During 1998 the company sold part of its building at Hverfisgata 105 and two automobiles. The net loss of the sale was 319 thousand ISK.

At year-end 1998 the official assessment value of buildings was 15,6 million ISK and the fire insurance value of the same was 27,9 million ISK.

Share investments

6. Shares in subsidiaries:

	Össur stodtaeki	Össur USA	Össur UK	Össur Lux	Total
Book value January 1st	(232.650)	(5.222.077)	(7.735.415)	(1.688.679)	(14.878.821)
Income 1998	65.100	1.610.506	5.535.384	6.454.317	13.665.307
Translation difference	(2.955)	(60.459)	106.186	207.806	250.579
	(170.505)	(3.672.029)	(2.093.845)	4.973.444	(962.935)
Shares in TVG-Ziemsen hf.					33.784
					(929.151)

- Share investments and intercompany investment income has been reduced of unrealized gain in inventories resulting from intergroup transactions. The unrealized gain, net of income tax effect, is 13.9 million ISK.

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 1999.

Inventories and short-term claims

8. Inventories are valued at the lower of cost or market. In 1998 the production of own products was transferred from Össur USA to the parent company. Finished products in the consolidated statements have been reduced by 19.9 million ISK of unrealized gain from intergroup transactions.

9. Accounts receivables are valued at cost plus incurred interest, less allowance for doubtful receivables.

10. Other receivables:

Value added tax, refund............	10.784.651
Current maturities of long-term bonds............	240.121
Prepaid expenses and miscellaneous	3.499.514
	14.527.286
Other receivables in subsidiary companies............	13.174.750
	27.702.036

11. *Marketable securities*

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

Notes to the financial statements

Owners' equity

12. Changes in the owners' equity accounts consist of the following during 1998 (ISK´000):

	Share capital	Legal reserve	Retained earnings	Total
Beginning balance	4.882.500	1.220.625	96.849.789	102.952.914
Gain on monetary position			(23.374)	(23.374)
Revaluation and translation gain			1.795.677	1.795.677
Net income for the year			79.113.372	79.113.372
Staða 31/12	4.882.500	1.220.625	177.735.464	183.838.589

- Of the 177.7 million ISK of retained earnings ISK 496 thousand is restricted for distribution.

Deferred income tax

13. An income tax liability of 13.1 million ISK 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 is postponed according to the tax law to future periods, and an income tax liability is recognized.

An increase of the income tax liability from previous year of 3.6 million ISK is expensed as income tax in the income statement. The difference is mainly explained by changes in share investments, less the effect of decrease in the tax rate from 33% in 1997 to 30% in 1998.

The consolidated income tax liability is 6.3 million ISK compared to 13.1 million ISK for the parent company. The difference is explained by the tax effect of the elimination of unrealized gain from intergroup transactions, as described in Notes 2 and 8.

Long-term liabilities

14. 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 1998 (ISK´000):

	Length	Interest	Terms	Remaining balance
Íslandsbanki, bank	2-4 yrs.	6-8,6%	Currency	92.500
Bond issue	3 yrs.	7,1%	LV	77.142
Fjárvangur - leasing comp.	4,5 yrs.	6,0%	LV	3.981
Glitnir - leasing comp.	1-2,5 yrs.	8,0%	Currency	4.189
Lýsing – financing comp.	2,5 yrs.	7,0%	USD / DEM	7.578
Bond payable	6 yrs.	4,5%	LV	8.656
FBA, investment bank	1-4 yrs.	3-6,5%	LV	10.769
				204.815
Long-term debt of subsidiary companies				3.366

The loans indicated by the term LV in the table above refer to a local index which accounts for general inflation.

The repayment schedule of these long-term loans is as follows (ISK´000):

Year due:

1999	24.588
2000	16.121
2001	156.906
2002	3.568
Later	3.632
	204.815

Taxation

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

- Income tax, parent company:

Calculated income tax levied in 1999	30.720.226
Increase in income tax liability	3.592.116
Calculated income tax of extraordinary expenses	3.464.603
	37.776.945

- Accrued taxes payable, parent company:

Income tax	30.720.226
Net worth tax	2.471.162
Other taxes	739.001
	33.930.389

Related party transactions

16. At the end of 1998 the parent company has claims against subsidiary companies in the amount of 180.9 million ISK. The total amount of intercompany sales was 605.9 million ISK during 1998 in addition to fees and other revenue of 37.9 million ISK. These intercompany balances and intercompany sales and transactions have been eliminated in the consolidated financial accounts.

Other items

17. Salaries to the executives of the company and the board of directors´ fee amounts to 17.7 million ISK.

18. The company has taken on lease the ground floor and the first floor at Grjótháls 5, Reykjavík. The lease expires in year 2007. Besides the company has an option to purchase the building, as a whole, with three months prior notice at fixed price pr. square meter. The cost price will be effected by changes in general prices. In 1998 the company´s lease payments for Grjótháls 5 amounted 25,2 million ISK.

Notes to the financial statements

19. At the end of the year 1998 51.4 million ISK of the company´s financial assets and 107.6 million ISK of its liabilities are denominated in foreign currencies.

20. The subsidiary company in Luxemburg, Össur Lux. S.A., will be merged with the parent company in 1999. The merger is not expected to require any additional expenditure for the group.

21. Since cost of royalty, amounting to 8 million ISK after taxes in 1998, will not recur in the future, it is disclosed in the income statement as a discontinued expense item.