aap Implantate AG

Annual Report

1998

1 aap Implantate AG at a Glance

All amounts in DM thousand	Pro-forma Group 1997	Group 1998	Change in 1997 to 1998 (in %)
Sales revenues	8,338	10,527	26.3
Materials expense	1,871	3,090	65.2
Personnel expense	3,661	5,615	53.4
Depreciation on fixed assets	487	704	44.6
Other operating expenses	2,905	4,102	41.2
Research and development expense	935	1,020	9.1
Profit/loss on ordinary operations	587	-281	-147.8
Net profit	538	16	-97.0
Fixed assets	3,239	5,045	55.7
Current assets	8,359	12,373	48.0
Capital and reserves (equity)	2,187	7,003	220.2
Provisions	622	1,348	116.7
Liabilities	8,879	8,909	0.3
Balance sheet total	11,689	17,783	52.1
Equity ratio in %	18.7	39.4	110.6
Debt ratio in %	81.3	60.6	-25.5
Employees (average over year)	48	82	70.8
DVFA/SG cash flow	1,055	856	-14.9
DFVA/SG earnings per share in DM	0.24	0.02	

aap Implantate AG

Annual Report 1998 of *aap* Implantate AG

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2 Executive Bodies

Supervisory Board

To August 12, 1998:

- **Eckhardt Manske, MSc (Math)**
  (Chairman)
- **Lothar Just**
  (Deputy Chairman)
- **Dr. Heinz-Helge Schauwecker**

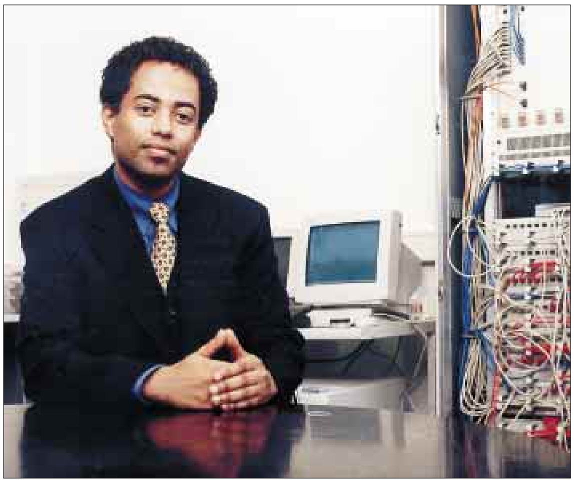
From August 13, 1998

- **Lothar Just**
  (Chairman)
- **Klaus Kosakowski MSc (Econ)**
  (Deputy Chairman)
- **Dieter Borrmann MSc (Eng.)**
- **Prof. Dr. Dr. h.c. Horst Cotta**
- **Susanne Rübenach MSc (Econ)**
- **Dr. Heinz-Helge Schauwecker**

Managing Board

- **Uwe Ahrens MSc (Eng.)**
  (Chairman)
- **Bruke Seyoum Alemu MSc (Eng.)**
- **Joachim Staub MSc (Eng.)**

Uwe Ahrens, MSc (Eng.) (Chairman)



Bruke Seyoum Alemu, MSc (Eng.)

Joachim Staub, MSc (Eng.)

Ladies and gentlemen, shareholders, friends

We thank you for your interest in our innovative and dynamic Company and hope that this Annual Report will give you a good picture of where we have come from, where we are now and where we are headed.

The center of our attention and effort is always mankind, preserving people's health and improving their quality of life. Researching the human skeleton and developing innovative "natural" life science products and organ implants for skeletal healing – this is where we at *aap* make our contribution. Internationalism, interdisciplinary research and the partnership-based approach – these are our corporate philosophy and the secret of our business success.

The long-term goal of *aap* Implantate AG is to make ourselves the market leaders in the field of biomedical engineering on the strength of our life science products. We see our stock market listing in May 1999 as the logical consequence of *aap*'s growth and an historic milestone in our Company's success story.

Ever since *aap* Implantate AG was founded in 1990, we have worked to create and extend an international network of customers, suppliers, academics, staff and shareholders. We maintain ongoing contact with research institutions and information centers around the world. The process of permanent exchange with scientists at congresses and direct contact with our customers and suppliers provide vital stimulus to our work. It follows that information transparency and our partnership network are important foundation stones for our Company's continuous growth.

The mystery of the human body is still far from revealed, the limits of the possible are still far from reached. Research into the organ of the human skeleton generates spin-off discoveries which permit inferences to be drawn about some parts of the organism. We are working to develop these insights – in the near or distant future - into microsystems and implants which will wholly or partially replace other organs in addition to bones, such as the heart or liver.

Investment in research and development is an important guarantor of *aap*'s future. We have already set global standards in skeletal healing. Today we service markets in more than 40 countries, and we plan to increase the global nature of our operations in future; we aim for *aap* to be internationally synonymous with life science products.

aap Implantate AG is permanently in a "state of flux" and for us, the path is the goal. As we continue to grow and change in the service of human health, we will of course keep you up to date with our progress. We invite you to share in the future of our business and to profit as partners and shareholders from *aap*'s growth and success.

We look forward to your company along the road and thank you for the trust you have placed in us.

Uwe Ahrens

Bruke Seyoum Alemu

Joachim Staub

1970
Mecron is founded to manufacture endoprostheses (implants as cures for irreparably damaged joints) and osteosynthesis products (temporary implants to help the healing of fractures).

1986
Johnson & Johnson takes over Mecron.

1990
aap Ahrens, Ahrens & Partner GmbH & Co. Betriebs KG is founded as a management buy-out (MBO) of subdivisions from the Johnson & Johnson subsidiary Mecron. The MBO leaves aap with more than 3.000 standard products from the Mecron portfolio, principally osteosynthesis products.

1992
aap increasingly develops its own innovative products, including a return to the endoprosthetics field, and moves to systematically divorce itself from its purely me-too products range. *aap*'s innovative organ implants give the Company the base to progressively attack its rivals in the market. Other innovative products include the launch of a ball-head screwdriver and recoilless hammer.
A series of classic standard products is supplemented by *aap*'s in-house innovations, typified by the Company's Orthner screw and Samii zinc screw for spinal applications.
aap skillfully exploits the outplacement strategy and continues to build on its position of quality and innovation leadership.

1995
aap redefines the state of the art. Its Tibia Biorigid Nail represents *aap*'s successful development of a virtually unbreakable, interlocking bone marrow nail for fracture support. The Tibia Biorigid Nail is patented in a range of European countries and the USA.
The Company's newly developed Acroplate, an implant for shoulder joint defects, is a runaway success in its first year.

1997
The superior performance of a new generation of hollow screws, now with self-tapping and self-threading capability, produces an excellent response in the marketplace. On September 10, *aap* Ahrens, Ahrens & Partner GmbH & Co. Betriebs KG converts into *aap* Implantate AG.

The continuous opening up of new markets enables export sales to grow at a rate of over 60%.

1998

aap becomes the number two player in the most important osteosynthesis segment (plates and screws), according to Marketline International Ltd.

aap launches its Biorigid Femur System, a unique frame construction kit for healing broken thighs. The system is exceptionally versatile and can be used for femur breakages, worn joints and tumors.

After three years of preparatory work, *aap* succeeds in December in winning certification as an environmentally responsible producer under the EU's eco-audit directive (EEC 1836/93).

While the sector expands by 3.5 percent in the year, *aap* posts turnover growth of 26 percent.

1999

At the start of the year, *aap*'s in-house developed products account for 20 percent of total turnover.

In the second quarter *aap* Implantate AG's shares are listed on the Neuer Markt of the Frankfurt Stock Exchange.

5 Product-Highlights

Tibia Biorigid Nail

Product description:

- Intramedullar load-bearing element for undrilled bone marrow nailing of the lower leg
- Solid titanium implant, 7 mm or 8 mm diameter
- 4.5 mm diameter locking screws (seat into predrilled grooves)

Application/indication:

- Tibia fractures from sealed simple fractures through to complicated open fragmented breaks in the medial and proximal range, but also fractures only slightly above the ankle.

Advantages:

- Non-allergenic, biocompatible material TiAl6V4 (titanium alloy)
- Prevents fat embolisms and heat necroses by eliminating predrilling of the marrow cavity
- Shortens OP time
- Dorsal flattening reduces implantation trauma
- Load-stable implant permits early mobilization (full stressing possible after just one week)
- Reduces x-ray burden
- Sophisticated custom toolkit permits x-ray-free cross-locking
- Eliminates 80% of follow-up OPs to remove locking bolts ("dynamizing")
- Implant failure rate < 0.1% (competing implants 12% - 24%)

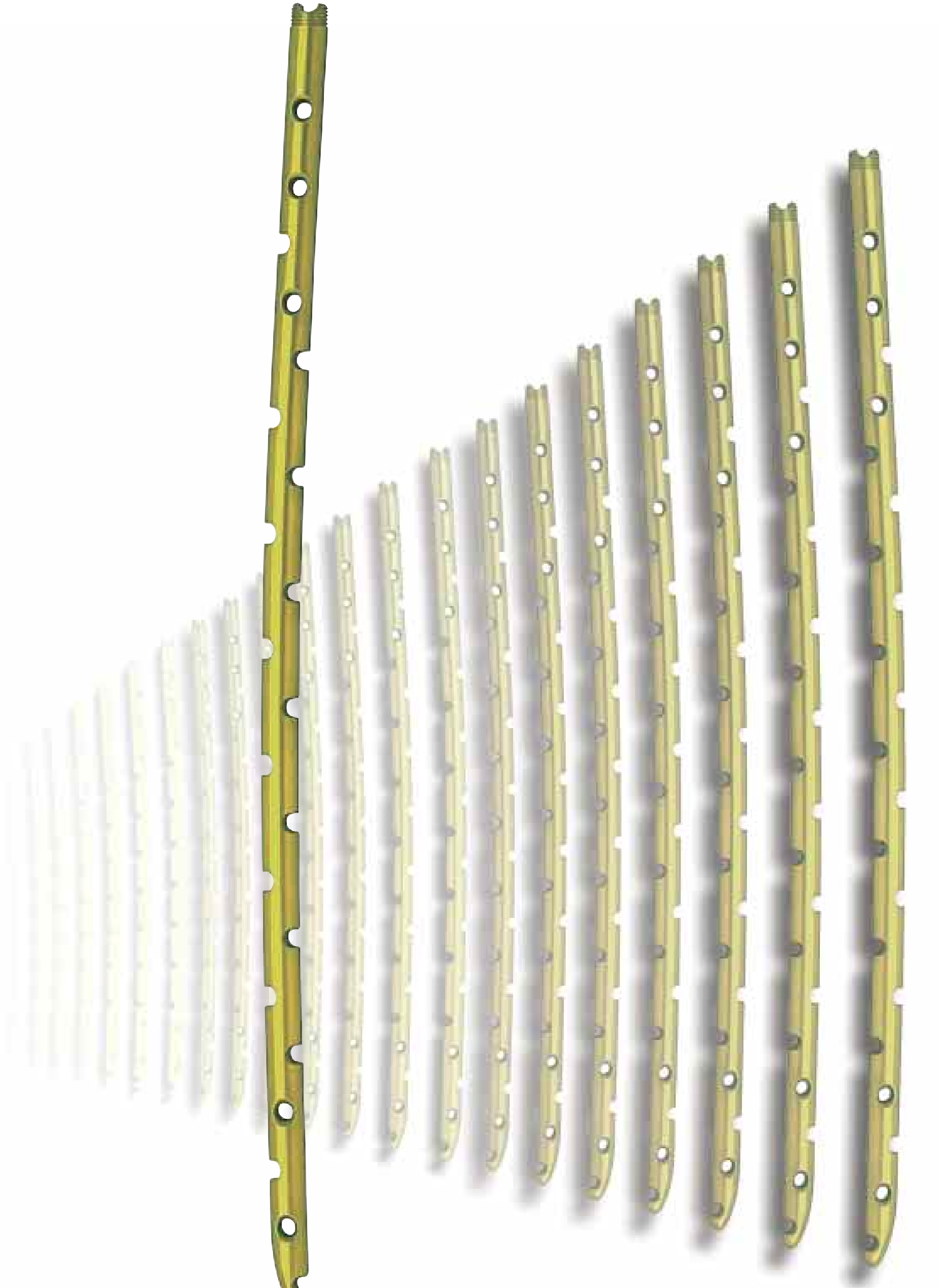
Market potential:

- DM 7.3 million (Germany)*

Market introduction:

- 1995

* Source: own research



Femur Biorigid Nail

Product description:
- Intramedullar load-bearing element for undrilled bone marrow nailing of the upper leg
- Solid titanium implant
- 10 mm, 12 mm, 14 mm diameter locking grooves and bores
- 5.3 mm diameter transverse locking screws

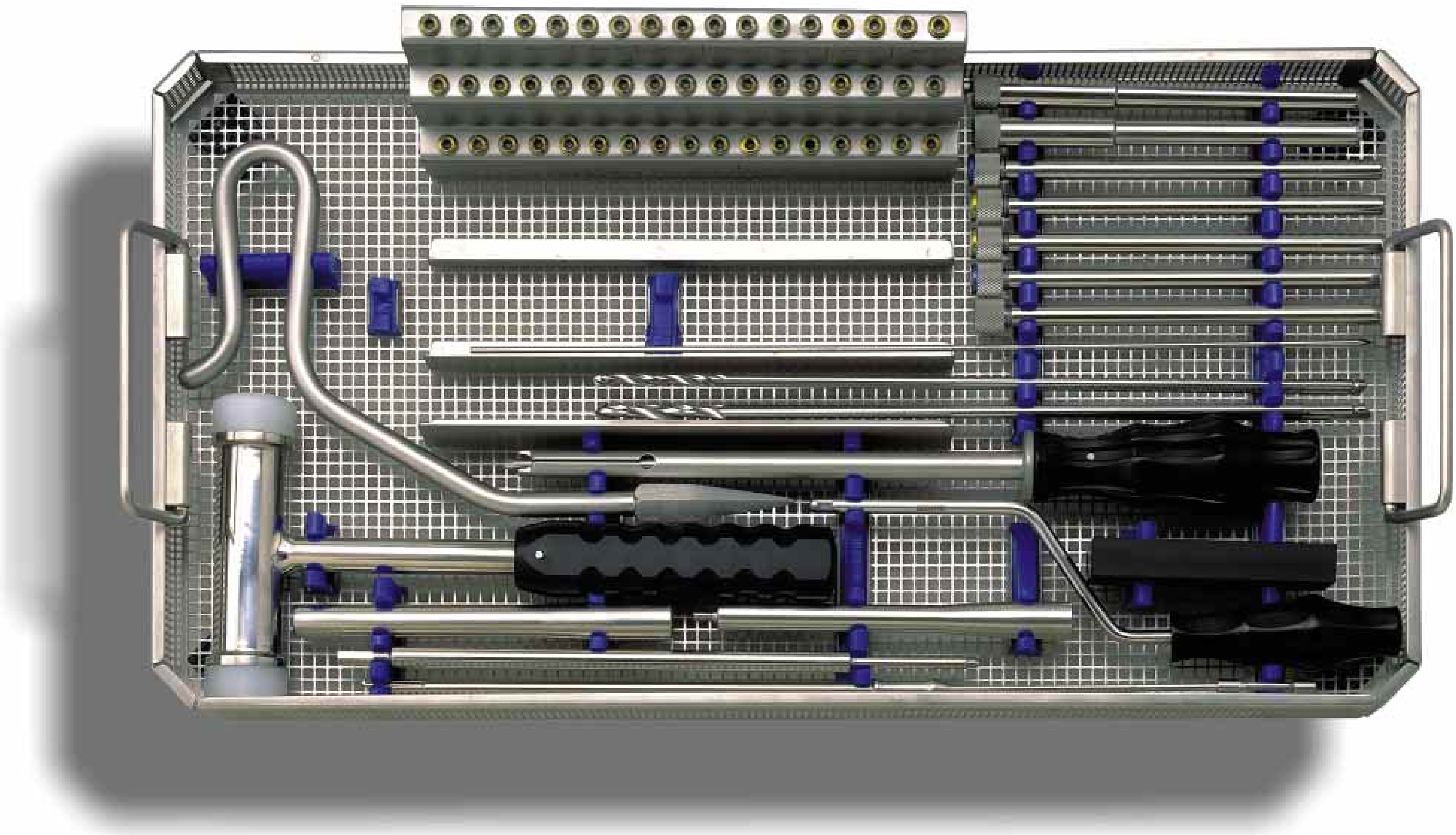
Application/indication:
- Thigh fractures (femur) from the hip socket to the femur condyles.

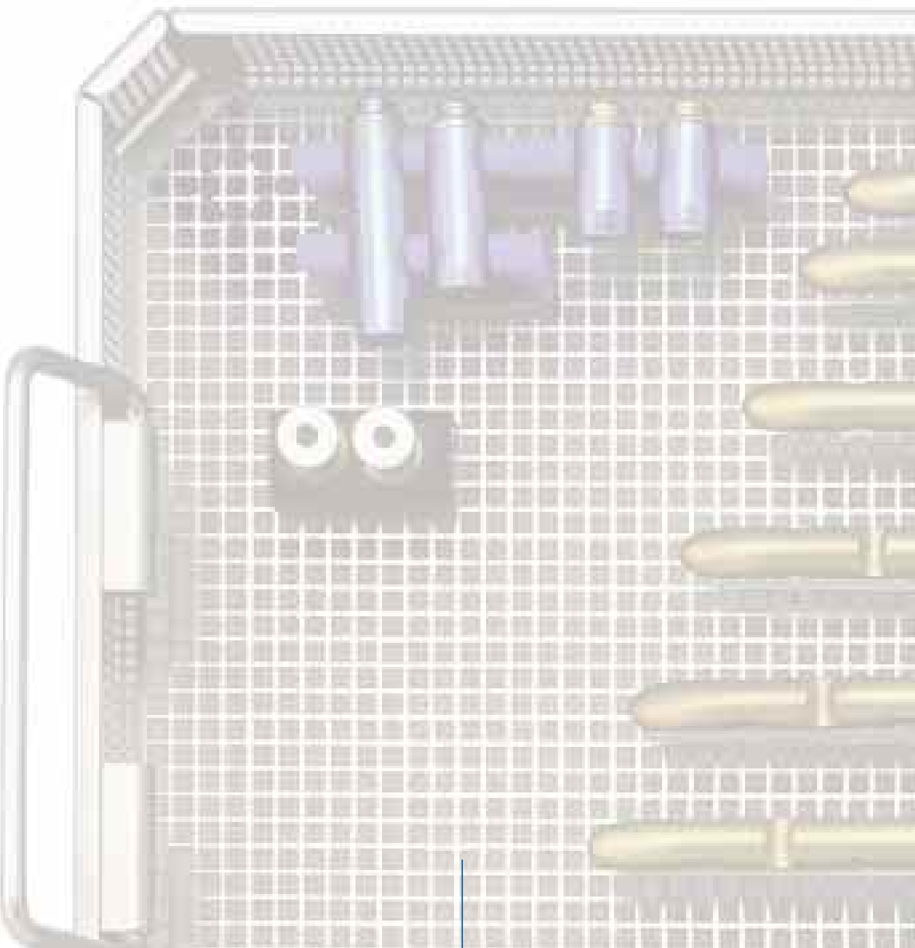
Advantages:
- Elasticity matches that of bone
- Can be screwed at any point over entire length
- New locking component provides extremely wide knee-side support options
- System is currently unique in the market
- Base component for BFS
- Angular locking option
- Can be implanted from either hip or knee side
- Biocompatible material, titanium TiAl6V4

Market potential:
- DM 13.2 million (Germany)*

Market introduction:
- October 1998

* Source: own research





Biorigid Femur System

Product description:

- Modular construction kit system for supporting femur shaft fractures through to hip or knee prosthesis support , e.g. as a revision prosthesis in the case of reoperations or tumor-induced bone degradation
- Base module and components made from titanium

Advantages:

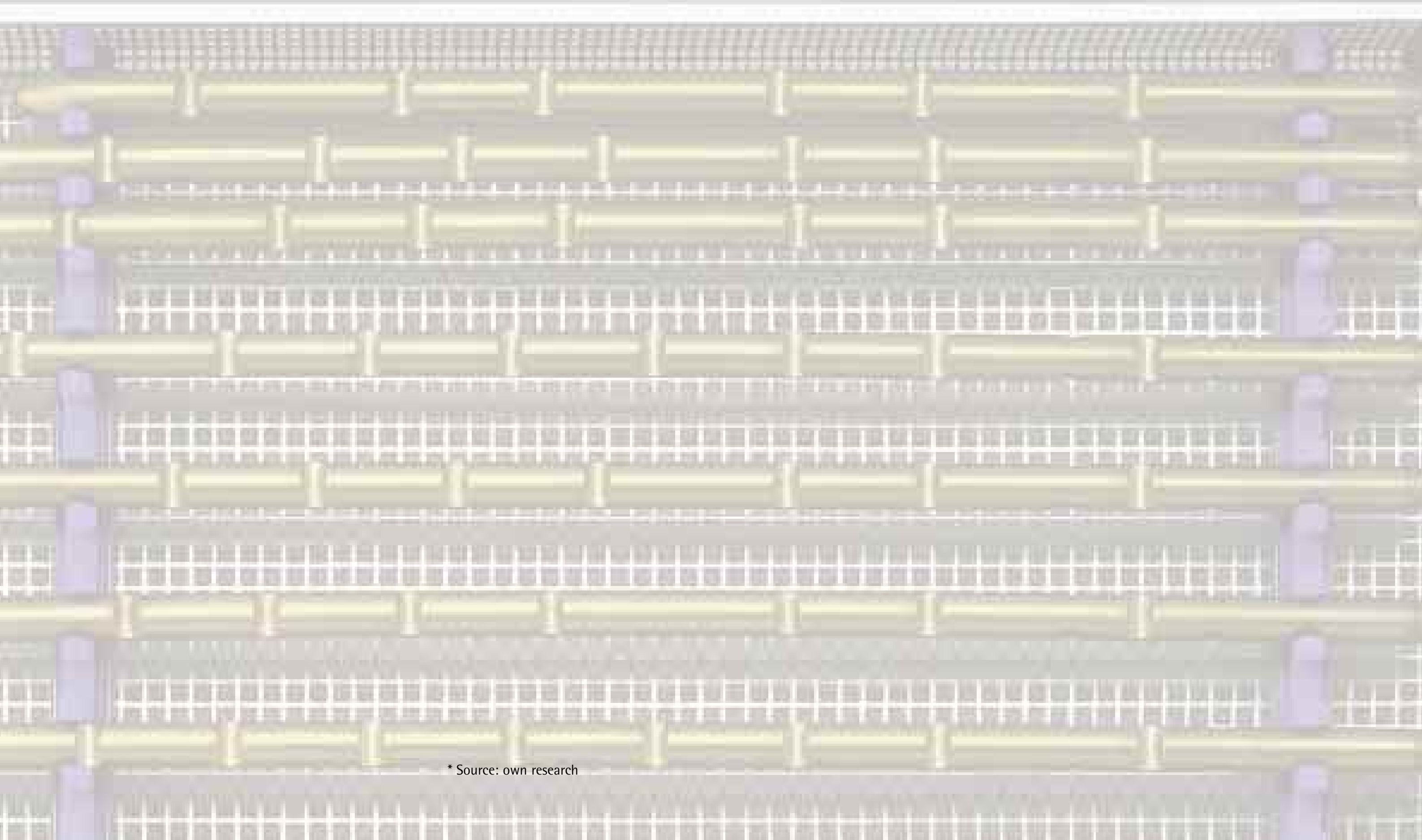
- Special component for stabilizing the femur neck area
- Hip prosthesis component
- The components provide extremely wide extension of the indications for the Femur Biorigid Nail base module
- Single tool set for all applications
- Biocompatible material, titanium TiAl6V4

Market potential:

- DM 67 million (Germany)*

Market introduction:

- Planned; system is currently at the clinical trials stage



* Source: own research


22/70mm aap
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APS System

Product description:

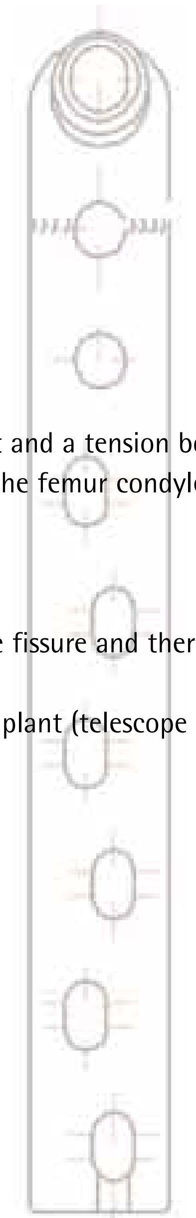
- System consisting of a plate with a cylindrical element and a tension bolt for supporting proximal femur fractures and fractures of the femur condyles
- Steel (CrNiMo) or biocompatible titanium (TiAl6V4)

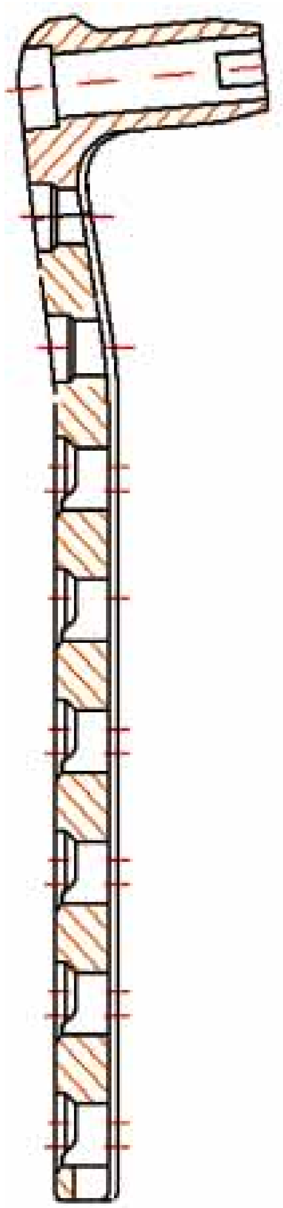
Advantages:

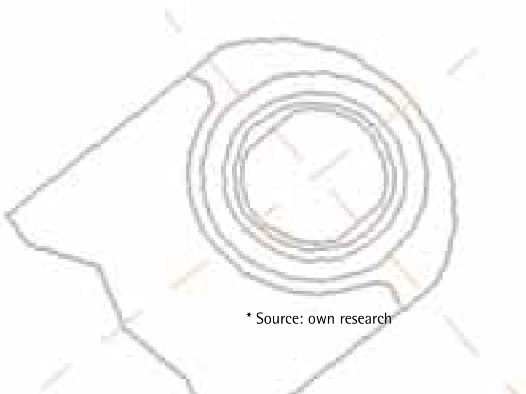
- Dynamic properties enable compression of the fracture fissure and therefore more rapid healing
- Also (uniquely) available in combination with a nail implant (telescope nail)
- Biocompatible material, titanium TiAl6V4

Market potential:

- DM 32 million (Germany)*







* Source: own research

7.5 mm Hollow Screws System

Product description:
- Implant system for supporting large-bone fractures
- Bored-through screw made of TiAl6V4 (titanium alloy) with a self-tapping, self-cutting thread inserted with the help of a guide wire previously located in the bone

Application:
- Support of fractures of the femur neck, femur condyles, tibia head or pelvis, repositioning osteotomy of the pelvis

Advantages:
- High-strength, biocompatible material (titanium)
- Eliminates the predrilling and thread-cutting process steps and therefore shortens OP time
- Previously optimally sited wires permit precise screw location
- Sophisticated custom tool set
- Easy to remove thanks to reverse-self-cutting thread

Market potential:
- DM 3.3 million (Germany)*

Market introduction:
- 1997

Small Hollow Screws System

Product description:
- Implant system for supporting small-bone fractures
- Bored-through screw made of TiAl6V4 (titanium alloy) with a self-tapping, self-cutting thread inserted with the help of a guide wire previously located in the bone.
- 3.5 mm, 4.0 mm, 4.5 mm diameter screws, with 1.2 mm and 1.6 mm diameter guide wires

Application/indication:
- Fractures of the carpal and tarsal bones, metacarpus and metatarsus, ankle, Volkmann triangle, Patella (heel bone), kneecap, upper and lower arm, second cervical vertebra, tibia head.

Advantages:
- High-strength, biocompatible material (titanium)
- Eliminates the predrilling and thread-cutting process steps and therefore shortens OP time
- Previously optimally sited wires permit precise screw location
- Modular tool set for all three sizes
- Fine size gradation (3.5 mm, 4.0 mm, 4.5 mm diameter screws) covers wide indications spectrum
- Easy to remove thanks to reverse-self-cutting thread

Market potential:
- DM 6.9 million (Germany)*

Market introduction:
- 1997

* Source: own research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AcroPlate

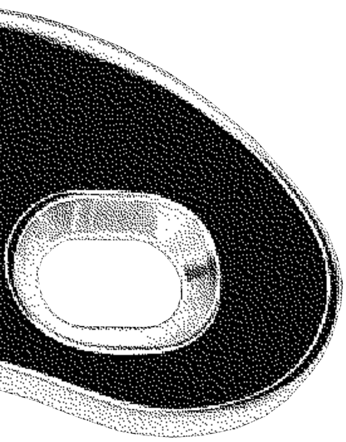
Product description:
- Hooked plate for supporting shoulder joint defects.

Application/indication:
- Luxations of the shoulder joint (acromio-clavicular joint)
- Fractures of the collar bone

Advantages:
- Minimal hook thickness and anatomically optimized angle prevent subacromial impingement ("bottleneck" syndrome below the roof of the shoulder)
- Short plate body permits a short incision, helping prevent injury to underlying nerves as well as providing cosmetic benefits
- Rapid rehabilitation, material can be removed after as little as eight weeks
- Biocompatible material (titanium)

Market potential:
- DM 1.4 million (Germany)*

Market introduction:
- 1996



* Source: own research

6 Report of the Supervisory Board

Thanks to a number of plenary sessions, various written reports and in-depth discussions between the Chairman and Deputy Chairman of the Supervisory Board and the Managing Board, the Supervisory Board remained fully informed about the situation and trading progress of *aap* Implantate AG during the 1998 financial year and assured itself of the proper conduct of the Company's management.

The Supervisory Board has examined fundamental issues of business policy as well as specific issues of particular importance with the Managing Board and has performed the duties imposed on it by law and the Company's statutes. The Supervisory Board's deliberations focused on the Company's proposed stock market listing and the expansion of its sales activities into new markets, most importantly Japan and the USA.

The Supervisory Board also appointed two new Managing Board members with effect from 1999 and concerned itself with the Company's overall business activity, investment and financing.

The firm of Dr Röver & Partner KG, Wirtschaftsprüfungsgesellschaft und Steuerberatungsgesellschaft, has audited the financial statements for the year to December 31, 1998 and the management report prepared by the Managing Board, and has approved them without qualification.

The annual financial statements, management report and auditor's report were all submitted in good time to the Supervisory Board for examination. The Supervisory Board found that there were no grounds for objection, and confirmed the auditor's conclusion.

The Supervisory Board has approved the annual financial statements and the management report prepared by the Managing Board, which are accordingly formally adopted. The Supervisory Board concurs with the Managing Board's proposal for the appropriation of the unappropriated net profit for 1998. The Ordinary General Meeting of *aap* Implantate AG held on August 13, 1998 formally approved the actions of the Supervisory Board during 1997.

The number of Supervisory Board members was additionally increased from three to six. The following were elected or re-elected:

Mr Dieter Borrmann
Professor Dr. Dr. h.c. Horst Cotta
Mr Lothar Just
Mr Klaus Kosakowski
Mrs Susanne Rübenach
Dr. Heinz Helge Schauwecker

Mr Roger Bendisch was elected to replace Mrs Rübenach. This election applies for the full term of office defined in the Company's statutes, namely until the end of the General Meeting which approves the actions of the Board during the year 2002.

We take this opportunity to once again thank Mr Eckardt Manske, who left the Supervisory Board during 1998, for his valuable contribution.

Berlin, February 1999

Lothar Just
Chairman

Financial Statements

of *aap* Implantate AG, Berlin, as of December 31, 1998 (HGB)

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The Company

Berlin-based *aap* Implantate AG is one of Germany's leading biomedical implants businesses. It also has a sales base in the USA. *aap*'s principal activity is the production and marketing of endoprosthetic products (which permanently replace damaged joints) and osteosynthesis products (temporary implants which help the healing of bone fractures).

aap develops and produces its products in-house and markets them in Germany through its own field sales force and distribution partners. The Company's field force consists mainly of engineers, whose role is to make sales, provide advice to customers, and also collaborate with clinical specialists to develop new implants. *aap*'s business partners are hospitals and doctors. *aap* also works with specialist dealers both nationally and internationally.

Information and financial management

Financial position/Profitability

The Company is able to report highly satisfactory turnover growth in 1998. The net profit on the year was DM 1,231 thousand which was more than double the 1997 result. As a percentage of total operating performance, this works out at 7.7% compared to 5.7% in 1997. The positive trend was even more pronounced at the pre-tax profit level. The 1998 total of DM 2,754 thousand was DM 2,205 thousand higher than the previous year.

However, this marked increase in earnings over the previous year is also partially due to the changes in the valuation methods for the 1998 financial statements and to the adjustment of the inventories valuation to bring it into line with the current costs structure. These methodological changes were implemented in preparation for the Company's proposed stock market listing and the resulting need to adopt international accounting standards. At the same time however, the 1998 financial statements do not include any capitalization of business expansion expenses, unlike the previous year.

The substantial increase in the asset value of the inventories heading is essentially due to the volume expansion of the stocks of goods held by the Company. This development again reflects preparation for the future expansion of business and is crucial to *aap*'s ability as a full-range supplier to offer short delivery times.

Three capital increases were undertaken in 1998 which have substantially improved the Company's financial position. In the process, the Company's registered capital was increased from DM 800,000.00 to DM 1.012 million, and the share premium added to the capital reserve amounted to DM 3.788 million. We were able to welcome new equity partners to the Company in the form of Investitionsbank Berlin, Technologiebeteiligungsgesellschaft Berlin and bmp AG Venture Capital & Network Management.

Products, markets and sales

Information technology
During 1998 the Company installed a new fully integrated management accounting software package which is one of the market-leading, top-quality solutions. This application subsequently allowed the Company to make the necessary preparations for the switch to the euro and to tackle the year-2000 problem.

Turnover growth
The evolution of turnover in 1998 was very satisfactory. Following the years of consolidation and the first upturn in 1997 (when turnover increased by 5.2% compared to the market's growth of 3.5%), the Company reaped the rewards in 1998 as turnover increased by 31.7%. The sales total reached DM 11.022 million and although this was DM 800,000.00 below plan, if we allow for the problems with the FDA (the American drug licensing authority) which were beyond the Company's control and which prevented the delivery of around DM 600,000.00 worth of goods to the US market, then the Company achieved its turnover target with less than 2% deviation from budget.

Market trends
The growth was spread across all the markets in which *aap* has had a years-long presence. The surge in growth which was signaled by the strong order book at the start of the year was sustained through the entire year and peaked in the fourth quarter, in which sales of more than DM 1 million were booked every month.

Segment analysis
This increase is justly reflected in the fact that *aap* now figures for the first time in every independent market research study. We are especially proud of the second place we occupy in the most important market segment plates and screws (which accounts for more than 60% of the entire osteosynthesis market). We have achieved this eminence in just 8 years and in the face of extremely tough competition. This market position, the still-growing order book of DM 1.31 million (compared to last year's average of DM 476 thousand), and the action we have already taken to increase capacity, all make a repeat of the above-trend growth pattern in 1999 appear a certainty.

The sales growth can be broken down into the direct sales force, specialist dealers and exports. All of these markets reported increases of at least 20%. Our own field force, which posted 22% sales growth, was a major factor in helping the Company to achieve the market position we have outlined. In the specialist dealers segment, our track record of demonstrated service quality during 1997 enabled us to extend our contract to supply Hamburg's hospitals for a further year.

This boosted sales in the dealers segment by over 30%. However, *aap* achieved by far its biggest growth in export sales, where an increase of more than 60% made this market the biggest contributor to earnings. It is particularly noteworthy in this context that this growth was achieved in spite of the crisis in Asia, previously one of our strongest markets, which left its mark on the sales figures; however, declines here were much more than compensated by strong growth in other markets, principally North Africa and South America.

If we look at the figures by reference to the Company's main product groups, the breakdown is as follows. As is traditional, traumatology products enjoyed the strongest growth, at 44%. Within this total the plates and screws segments notched up increases of 45% and 50% respectively, a feat which was impressively confirmed by our second place in the market ranking. In the nails section too, we can be very satisfied with a growth rate of 23%, the product of our continuous product development and innovation. With sales of our biorigid tibia nail expanding by just under 79%, we can also point to the successful market launch of one more innovative engineered biomedical product. We will continue to concentrate in future on launching biologically optimized products.

The 20% sales growth recorded by the Endoprosthetics division was also way above the market growth (not to mention our own planning), which was a very good outcome in view of the division's current product range which needs renewing in some areas. New products will be the Company's number one priority in this division as well in the future, to ensure that *aap* becomes as firmly established in orthopedics as it is already in traumatology.

The Company's strategy for achieving this goal is to devote special attention to biological healing mechanisms and to the reactions at the interface between biology and engineering.

1999 will be dominated by the market launch of a pioneering modular system for the biologically-supported healing of femur fractures which will simultaneously lend itself to use as a joint replacement and as a tumor prosthesis. This modular system is currently unique on the market and has been developed with a particular eye to the market's needs. It offers doctors a total solution which is not available in a similar form from any competitor. The Company's new hollow-point screw system, introduced in early 1998, will also drive sales and its now mature version will translate into significant market share.

During 1998 *aap* took part in 34 exhibitions and congresses. *aap* presented itself as one of the most innovative companies in the field of biomedical engineering at a total of seven international events.

aap's successful participation in international events was also one of the factors which led to the decisive contact which has resulted in a new marketing alliance in Japan. The new partner the Company has acquired through this route is one of the most renowned players in the Japanese market for spinal column surgical products, where it leads the market. Backed by a reputation of this caliber, we are relatively confident that *aap*'s trauma and endoprosthetics products will also experience a positive launch in Japan.

Production and technology

We can assess the increase in productivity achieved last year as extremely positive. Output was expanded by 52% while the number of people employed in manufacturing only increased by 34%. Especially pleasing in this context were the productivity advances of over 45% in osteosynthesis plates and over 60% in osteosynthesis screws. It looks very much as if we will be able to improve significantly on these rates of increase again as we will be bringing new-technology manufacturing machines (high-speed machining centers) and more productive new capacity on stream during 1999. To this end, we implemented capital expenditures in the order of DM 1.3 million during 1998.

Research and development

From its inception *aap* has always staked its future on high-speed development and high-power innovation. In order not just to maintain but to surpass this exceptional level of R&D performance, we plan a range of joint initiatives with universities and opinion formers in the coming year.

A key feature of 1998 was the large number of projects in which we collaborated with our customers to jointly refine specific products. Equally, our new product development function again created successful articles for the market under the guidance of customers. The introduction of our new family of hollow-point screws in 1998 was a great success. A particular highlight of the year came in Autumn, when we launched the improved version of our undrilled tibia nail, the biorigid femur nail and the biorigid femur management system or BFS. This universal application system for trauma or wear-damaged femurs was extremely well received in the marketplace. Intensive marketing of this product will provide a significant stimulus to sales in 1999 as well.

Further new projects were commissioned for completion during 1998 and in the future to sustain our combined strategic focus on the biology and engineering dimensions. The spectrum of project goals ranges from the development of new highly-innovative implants to breakthrough bio-interface and joint cartilage applications.

In addition, 1998 brought the launch of our first international project with the USA. This will also produce a very promising bone organ supply product.

The Company's research and development expense again represented a more than 10% share of turnover in 1998.

Quality and environmental management

Quality performance

The many product launches which fell into 1998 produced a slight setback in the improving trend of our quality statistics. We could not maintain the positive trend which had reduced the reject rate from 2.25% originally to 0.45% in 1997, and were obliged to report a slight rise due to problems in the manufacturing of new products. The causes of the faults were identified and the quality management department is extremely confident that the statistics will resume their positive pattern again in 1999.

Environmental audit

Especially good news is that we gained certification as an environmentally responsive manufacturer during 1998 after three years of preparation. As from December 31, 1998, *aap* Implantate AG's site at Lorenzweg 5 is registered with Germany's environmental inspection agency, the IHK, (registration number: DE-S-107-0046) under the provisions of the European eco-audit directive (EEC 1836/93) as having a certified environmental management system. This makes *aap* one of the first producers in the biomedical engineering industry to adopt this strict standard.

Employees

The rapid growth of the Company will continue to present *aap* with a stiff human resources challenge in 1999. As always, *aap*'s policy is to prioritize the recruitment of highly qualified and intelligent personnel who are then given intensive training in-house for their future duties.

The average size of the workforce is planned to expand from 67 to 88 during 1999. A program of regular training courses, both internal and external, as described in our quality management procedures, is intended to ensure our employees maintain the high level of know-how and service quality which is universally acknowledged by our customers.

▶ Stock market listing and IPO

The Company plans to list on the stock market in 1999. The necessary preparations, specifically the selection of the consortium banks and the generation of the listing prospectus, are largely completed.

▶ Outlook and prospects

aap Implantate AG has demonstrated exceptional performance again in 1998, thanks to comprehensive controlling and benchmarking. This tradition arms us to embrace the future in 1999 and beyond with confidence.

In spite of the enormous surge in sales at the year-end, we open 1999 with orders in hand of over DM 1.9 million, which is more than DM 1.1 million higher than the figure at this time last year. Accordingly, we foresee further turnover significant growth in 1999.

The dominant theme of 1999 is our proposed stock market listing and IPO, which we expect to provide an especially positive boost.

Berlin, January 25, 1999

Uwe Ahrens
(Chairman, Managing Board)

Bruke Seyoum Alemu
(Managing Board)

Balance Sheet of *aap* Implantate AG as at December 31, 998

ASSETS

	Note	DM	Dec. 31, 1998 DM	Dec. 31, 1997 DM thousand
A. Business expansion expenses	(4)		662,073.00	974
B. Fixed assets	(4)			
I. Intangible assets				
1. Industrial property rights and similar rights and values		398,471.00		13
2. Goodwill		1.00		0
			398,472.00	13
II. Tangible assets				
1. Land and buildings		1,609,182.00		1,625
2. Technical plant and machinery		1,239,872.26		284
3. Other plant, office systems and outfitting		1,267,920.00		786
			4,116,974.26	2,695
III. Financial assets				
1. Shares in affiliated companies		0.00		0
2. Equity investments		2,000.00		0
3. Other lendings		231,288.91		187
			233,288.91	187
C. Current assets				
I. Inventories				
1. Raw materials and supplies		1,280,425.85		718
2. Work in process		1,865,264.21		558
3. Finished products and merchandise		6,661,965.40		3,080
			9,807,655.46	4,346
II. Receivables and other assets	(5)			
1. Trade receivables		1,259,689.96		1,120
2. Due from affiliated companies		822,891.22		45
3. Other assets		1,026,942.94		322
			3,109,942.94	1,487
III. Checks, cash in hand, Bundesbank, bank and girobank balances			77,816.78	38
D. Deferred charges to operation, prepayments	(6)		169,819.91	80
			18,575,624.44	9,820

EQUITY AND LIABILITIES

	Note	DM	Dec. 31, 998 DM	Dec. 31, 1997 DM thousand
A. Equity	(7)			
I. Registrated capital			1,012,000.00	800
II. Capital reserve			4,622,120.00	34
III. Revenue reserve				
1. Statutory reserves		81,565.83		28
2. Other revenue resreves		508,875.36		0
			590,441.19	28
IV. Attributable profit			508,875.36	-159
			6,733,436.55	703
B. Special items in respect to fixed assets investment subsidies			522,867.00	0
C. Provisions	(8)			
1. Provisions for taxes		1,525,801.00		0
2. Other provisions		892,000.00		238
			2,417,801.00	238
D. Liabilities	(9)			
1. Liabilities to banks		4,809,542.42		5,565
2. Trade payables		1,669,414.54		1,353
3. Liabilities to associated companies		20,939.34		23
4. Other liabilities which arising from tax: DM 210,359.50 (1997: DM 157 thousand) of which arising from social security: DM 143,980.78 (1997: DM 229 thousand)		2,400,929.02		1,937
			8,900,825.32	8,878
E. Deferred credits to income, prepayments			694.57	1
			18,575,624.44	9,820

Income Statement of *aap* Implantate AG for the Year to December 31, 1998

	Note	DM	DM	Dec. 31, 1997 DM thousand
1. Sales revenues	(10)		11,022,084.41	8,367
2. Increase in stocks of finished products and work in process			4,900,198.27	558
3. Other capitalized own work			231,582.39	249
4. Other operating income			344,515.56	150
5. Materials expense				
a) Expenditures on raw materials and supplies and bought-in goods		-2,462,928.09		-1,547
b) Expenditure on bought-in services		-577,624.31		-190
			-3,040,552.40	-1,737
6. Personnel expenses	(11)			
a) Wages and salaries		-4,620,122.08		-2,570
b) Social security contributions, pension and welfare expenses		-884,134.78		-641
			-5,504,256.86	-3,211
7. Depreciation on tangible and intangible fixed assets and on capitalized business expansion expenses			-963,889.73	-543
8. Other operating expenses			-3,963,961.99	-2,901
9. Income from lending of financial assets			13,960.00	0
10. Other interest and similar income - of which from affiliated companies: DM 3,831.94 (1997: DM 0 thousand)			11,766.79	15
11. Other interest and similar expenses			-454,787.58	-502
12. Profit/loss from ordinary operations			**2,596,658.86**	**445**
13. Extraordinary income	(12)		157,937.50	111
14. Extraordinary expense			0.00	-7
15. Net extraordinary income/expense			**157,937.50**	**104**
16. Taxes on income	(13)		-1,524,248.76	-3
17. Other taxes			481.88	-1
18. Net profit for the year			1,230,829.48	545
19. Difference arising from change of legal form			-159,512.93	-676
20. Allocation to revenue reserves				
a) to the statutory reserve		-53,565.83		-28
b) to other revenue reserves		-508,875.36		0
			-562,441.19	-28
21. Attributable profit/loss			508,875.36	-159

Notes to the financial statements

(1) General

The financial statements for the year to December 31,1998 have been prepared in accordance with the requirements of the German Commercial Code (HGB).

The universal requirements defined by Articles 238 to 263 HGB, which applies to all trading enterprises, and the supplementary requirements for incorporated entities imposed by Articles 264 ff. HGB, have been complied with.

The income statement was prepared on the total-cost basis.

The formats of the balance sheet and income statement are in accordance with Articles 266 and 275 HGB.

The Company is the successor, through a change of name and legal form which took effect as from January 1,1997, to the limited company and partnership *aap* Ahrens, Ahrens & Partner GmbH & Co. Betriebs KG. The balance sheet values applying at December 31, 1996 were carried over. The registered capital is evidenced through undisclosed reserves for which no disclosure was necessary because there was no transfer of assets under civil law. The "difference arising from the change of legal form" was due to the offsetting of the limited partners' loss accounts against the contributions of the shareholders at the time of the Company's transformation; this difference has been carried forward as a residual loss and set against net profit.

(2) Accounting and valuation principles

Contrary to the previous years' practice, business expansion expenditures during the year under report have not been capitalized.

The balance sheet allowance item created in previous years under the terms of Article 269 HGB is depreciated at the rate of 25% in the subsequent years under the provisions of Article 282 HGB.

Intangible assets were valued at their cost of acquisition less regular depreciation.

Tangible fixed assets have been valued at their cost of acquisition or manufacture, and the value of tangible assets with a limited useful life has been reduced by regular depreciation.

Capitalized own work has been valued at cost of production. The production costs are equivalent to the reported value of finished products.

Non-real-estate fixed assets are depreciated on a straight-line basis subject to the respective minimum standard service life permitted by the tax authorities, with additions in the first half of the year qualifying for the full depreciation rate applying to and additions during the second half of the year qualifying for half the relevant depreciation rate. Low-value assets with a purchase cost of up to DM 800.00 are written off in full in the year of accrual, as provided for by Article 6 (2) of the German income tax act (EStG).

Disposals are taken out of the books at cost of acquisition less cumulative depreciation at the date of retirement.

Financial assets are carried at cost of acquisition or updated book value.

The items included in the inventories heading are valued either at cost of acquisition or manufacture, or the lower of cost or market on the balance sheet date.

Raw materials and supplies were valued at procurement cost, subject to the strict principle of the lower of cost or market defined by Article 253 (3) HGB.

Work in process and stocks of finished products have been valued at cost of manufacture. This measure includes the capitalizable direct costs defined by Article 255 (2) 2 HGB plus appropriate portions of the essential materials and production overheads and fixed asset value erosion due to production, as defined by Article 255 (2) 3 HGB.

Contrary to the previous years' practice, the manufacturing costs also incorporated general administration costs.

To ensure observance with the principle of the lower of cost or market defined by Article 253 (3) HGB, some values were written down to reflect restricted salability.

Receivables and other assets are carried at their nominal value or at their realizable value at the accounting date if lower, as required by Article 253 (3) 2 HGB. General credit risk is accommodated through a global bad debt provision amounting to 3% of the stock of non-specifically-adjusted receivables.

Received investment grant aid is entered on the liabilities side as a "special item in respect of fixed-asset investment subsidies". This is liquidated in the income statement on a straight-line basis reflecting the service life of the subsidized assets.

Provisions have been made to take appropriate account of the foreseeable risks. They have been set at the levels commensurate with prudent commercial judgement.

Outstanding liabilities have been valued at their repayment value.

Foreign currency liabilities have been translated at their repayment value at origination or at the selling rate applying on accounting date if higher.

(3) Impact of differing accounting and valuation principles on profitability

The differences in accounting and valuation methods produce the following effects on the Company's earnings:

	DM thousand
Available but not utilized allocation to Article 269 HGB balance sheet allowance	-244
First-time inclusion of overhead administration costs in valuation of finished products and work in process	2,195
Negative impact of income tax on changes in valuation of finished products and work in process (60%)	-1,295
	620

Notes to the balance sheet and income statement

(4) Business and fixed-asset expansion expenses

The statement of fixed assets movements shows the changes in the capitalized expenditure on business and fixed-asset expansion.

(5) Current assets

The **receivables and other assets** heading includes a loan repayable in more than one year

Loan to Mr Siewert	DM 14,600.00

(6) Deferred charges to operation, prepayments

This heading includes discounts totaling DM 40,262.00.

(7) Equity

The Company's registered capital was DM 1,012,000.00 at December 31,1998, divided into 202,400 unit bearer shares.

The Supervisory Board meeting held on January 15, 1998 approved the Managing Board's resolution of January 14, 1998 to undertake a DM 100,000.00 capital increase from authorized capital to a then new total of DM 900,000.00.

This measure was recorded in the Commercial Register on February 23, 1998. The capital increase was implemented through the issue of 20,000 bearer shares with a nominal value of DM 5.00.

Payment for the new shares was received during February 1998, and totaled DM 1,125,000.00 including premium. By agreement, the sum of DM 375,000.00 received as a loan in December 1997 was transferred to the capital reserve following the recording of the capital increase in the Commercial Register.

By virtue of a Managing Board resolution of May 20, 1998, affirmed by the Supervisory Board on May 28 and June 02, 1998, the Company's registered capital was raised to DM 920,000.00 by the issue of a further 4,000 bearer shares with a nominal value of DM 5.00. This measure was recorded in the Commercial Register on June 16, 1998 and the payment in respect of the new shares of DM 280,000.00 including premium was received on June 02, 1998.

A further Managing Board resolution of August 13, 1998, affirmed by the Supervisory Board on August 13, 1998, authorized an increase of the Company's registered capital by DM 92,000.00 to DM 1,012,000.00. This capital increase was implemented through the issue of 18,400 unit bearer shares. This measure was recorded in the Commercial Register on October 01, 1998 and the payment in respect of the new shares of DM 3,000,120.00 (including premium) was received on August 25, 26 and 28, 1998.

The Company's capital reserve evolved as follows over the year:

		DM
Position at	January 1, 1998	34,000.00
Capital increase	January 15, 1998	1,025,000.00
Deposit	February 23, 1998	375,000.00
Capital increase	May 20, 1998	280,000.00
Capital increase	August 13, 1998	2,908,120.00
Position at	**December 31, 1998**	**4,622,120.00**

One-twentieth of the annual net profit, after offsetting the brought-forward loss, was allocated to the statutory reserve as required by Article 150 (2) of Germany's stock corporation act (AktG). This accordingly stood at DM 81,565.83 at the end of the year and, taken together with the capital reserve, now exceeds one-tenth of the Company's registered capital.

The Company's statutory reserve evolved as follows over the year:

		DM
Position at	January 1, 1998	28,000.00
Allocation from annual profit		53,565.83
Position at December 31, 1998		**81,565.83**

The table of reserves shows the detailed position.

In compliance with the first sub-sentence of Article 24 (1) 1 of the Company's statutes, the Managing Board and Supervisory Board transferred 50% of the 1998 net profit remaining after the cancellation of the loss-carryover and the allocation to the statutory reserve, to the Company's other revenue reserves. In their invitation to the Annual General Shareholders Meeting scheduled for February 22, 1999, the Managing Board and Supervisory Board proposed allocating the attributable profit of DM 508,875.36 to the other revenue reserves.

(8) Provisions

Other provisions evolved as follows during the year:

	Position at Jan. 1, 1998	(U) (L)	Utilization Liquidation	New allocation	Position at Dec. 31, 1998
Staff holiday entitlements	96,200.00	(U)	-96,200.00	176,000.00	176,000.00
Annual accountancy and audit costs	30,000.00	(U)	-22,171.20		
		(L)	-7,828.80	60,000.00	60,000.00
Bonus obligations	60,000.00	(U)	-33,036.52		
		(L)	-26,963.48	115,000.00	115,000.00
Trade association	25,000.00	(U)	-21,923.25		
		(L)	-3,076.75	25,000.00	25,000.00
Performance-related bonus	25,000.00		0.00	98,000.00	123,000.00
Commission obligations	0.00		0.00	60,000.00	60,000.00
Outstanding invoices	0.00		0.00	43,000.00	43,000.00
Litigation costs and risks	0.00		0.00	20,000.00	20,000.00
Disabled employment equalization levy	1,600.00	(L)	-1,600.00	0.00	0.00
Interest due to dormant shareholders	0.00		0.00	20,000.00	20,000.00
Other risks	0.00		0.00	250,000.00	250,000.00
	237,800.00	**(U)**	**-173,330.97**		
		(L)	**-39,469.03**	**867,000.00**	**892,000.00**

(9) Liabilities

The table of liabilities shows the residual term of the Company's liabilities broken down by balance sheet headings.

(10) Sales revenues

The revenues relate to geographical regions as follows:

	DM thousand
Germany	6,666
Rest of EU	854
Rest of world	3,737
Revenue deductions	-235
	11,022

(11) Personnel expenses

Breakdown of the workforce by groups:

Average employee		
total:		80
of which:	female	12
	male	68
Hourly paid		49
Salaried		31

(12) Exceptional income

The exceptional income heading includes government return-to-work subsidies from the Labor Office, amounting to DM 157,937.50 (1997: DM 110,888.09).

(13) Taxes on income

The impact of taxes on the Company's profit from its ordinary operations and net extraordinary income was as follows:

	DM
Profit from ordinary operations	1,436,756.89
Net extraordinary income	87,491.87
Taxes on income	**1,524,248.76**

Other information

(14) Managing Board, Supervisory Board

The sole member of the Company's Managing Board during the year was Dipl.-Ing. Uwe Ahrens (MSc Eng.).

The Company exercises its right under article 286 (4) HGB not to disclose the Managing Board's remuneration.

The Company has granted its Managing Board member Dipl.-Ing. Uwe Ahrens a deferment on paying its entitlement to a purchase price of DM 28,000.00 for the assignment of its shares in Prothos medizinische und Sportprodukte GmbH. Incremental interest of 5% is payable on this amount. The deferment may be revoked subject to three months notice to the year end.

The following were members of the Supervisory Board during the year under report:

To August 12, 1998:
Eckardt Manske,
MSc (Math), Berlin
(Chairman)

Lothar Just, Berlin,
chartered auditor and tax consultant
(Deputy Chairman)

Dr. Heinz Helge Schauwecker,
Berlin,
head physician and senior lecturer

From August 13, 1998:
Lothar Just, Berlin,
chartered auditor and tax consultant
(Chairman)

Klaus Kosakowski,
MSc (Econ), Berlin
(Deputy Chairman)

Dieter Borrmann,
MSc (Eng.), Berlin

Prof. Dr. Dr. h.c. Horst Cotta,
Heidelberg

Susanne Ropertz,
MSc (Econ), Bonn

Dr. Heinz Helge Schauwecker,
Berlin,
head physician and senior lecturer

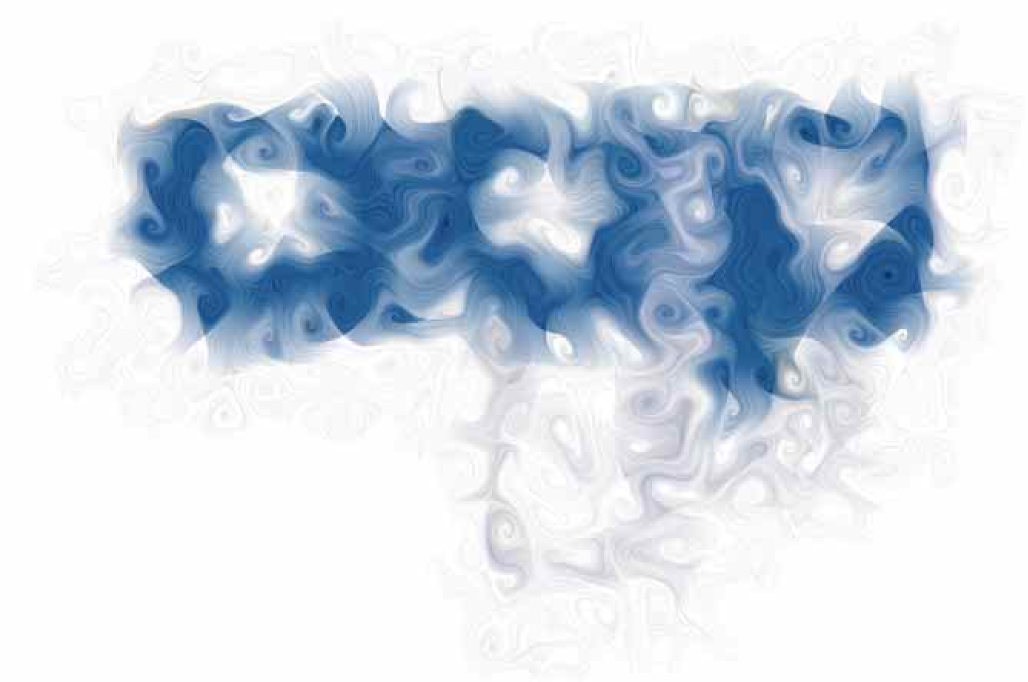
The Supervisory Board received total remuneration of DM 66,000.00 in the year.

Under the terms of an agreement dated April 23, 1998, the Company was co-founder of *aap* Implants Inc. in Plymouth, Massachusetts, USA. The ownership structure of this company is as follows:

aap Implantate AG	80 %
Joachim Staub	10 %
Wayne R. Knupp	5 %
Ellen J. Knupp	5 %
	100 %

Statement of Fixed-Assets Movements of *aap* Implantate AG for the Year to December 31, 1998

	Historical acquisition costs			
	Position at Jan. 1, 1998 DM	Additions DM	Disposals DM	Position at Dec. 31, 1998 DM
A. Business start-up and expansion expenses	1,249,941.84	0.00	0.00	1,249,941.84
B. Fixed assets				
I. Intangible assets				
1. Industrial property rights and similar rights and values	144,585.29	437,234.54	-14,967.47	566,852.36
2. Goodwill	100,000.00	0.00	0.00	100,000.00
	244,585.29	437,234.54	-14,967.47	666,852.36
II. Tangible assets				
1. Land and buildings	1,640,000.00	0.00	0.00	1,640,000.00
2. Technical plant and machinery	4,408,152.27	1,249,112.68	-53,685.00	5,603,579.95
3. Other plant, office systems and outfitting	1,599,770.20	822,871.65	-227,312.43	2,195,329.42
	7,647,922.47	2,071,984.33	-280,997.37	9,438,909.37
III. Financial assets				
1. Shares in affiliated companies	0.00	0.00	0.00	0.00
2. Equity investments	0.00	2,000.00	0.00	2,000.00
3. Other lendings	186,828.91	44,460.00	0.00	231,288.91
	186,828.91	46,460.00	0.00	233,288.91
Total	9,329,278.51	2,555,678.87	-295,964.90	11,588,992.48



Cumulative depreciation				Book values	
Position at Jan. 1, 1998 DM	Depreciation current year DM	Disposals DM	Position at Dec. 31,1998 DM	Position at Dec. 31, 1998 DM	Position at Dec. 31, 1997 DM
275,383.52	312,485.52	0.00	587,868.84	662,073.00	974,558.32
131,982.29	51,361.54	-14,962.47	168,381.36	398,471.00	12,603.00
99,999.00	0.00	0.00	99,999.00	1.00	1.00
231,981.29	51,361.54	-14,962.47	268,380.36	398,472.00	12,604.00
15,409.00	15,409.00	0.00	30,818.00	1,609,182.00	1,624,591.00
4,123,737.27	246,676.42	-6,706.00	4,363,707.69	1,239,872.26	284,415.00
813,144.40	337,957.45	-223,692.43	927,409.42	1,267,920.00	786,625.80
4,952,290.67	600,042.87	-230,398.43	5,321,935.11	4,116,974.26	2,695,631.80
0.00	0.00	0.00	0.00	0.00	0.00
0.00	0.00	0.00	0.00	2,000.00	0.00
0.00	0.00	0.00	0.00	231,288.91	186,828.91
0.00	0.00	0.00	0.00	233,288.91	186,828.91
5,459,655.48	963,889.73	-245,360.90	6,178,184.31	5,410,808.17	3,869,623.03

Table of liabilities as at December 31, 1998

	Total value Dec. 31, 1998 DM	up to 1 year DM	Repayable in 1 to 5 years DM	over 5 years DM
Liabilities to banks	4,809,542.42	1,966,312.35	2,413,268.79	429,961.28
Trade payables	1,669,414.54	1,669,414.54	0.00	0.00
Liabilities to associated companies	20,939.34	20,939.34	0.00	0.00
Other liabilities				
– in relation to social security	143,980.78	143,980.78	0.00	0.00
– in relation to taxation	210,359.50	210,359.50	0.00	0.00
– sundry liabilities	2,046,588.74	1,129,639.55	688,949.19	228,000.00
	8,900,825.32	**5,140,646.06**	**3,102,217.98**	**657,961.28**

The Company's liabilities to banks are secured to the value of DM 2,300,000.00 through mortgages and the assignment as security of various machines and receivables.

Table of reserves as at December 31, 1998

	Position at Jan. 1, 1998 DM	Allocation from annual profit DM	Endowment during year DM	Position at Dec. 31, 1998 DM
I. Capital reserve	34,000.00	0.00	4,588,120.00	4,622,120.00
II. Revenue reserves				
1. Statutory reserves	28,000.00	53,565.83	0.00	81,565.83
2. Other revenue reserves	0.00	508,875.36	0.00	508,875.36
	62,000.00	**562,441.19**	**4,588,120.00**	**5,212,561.19**

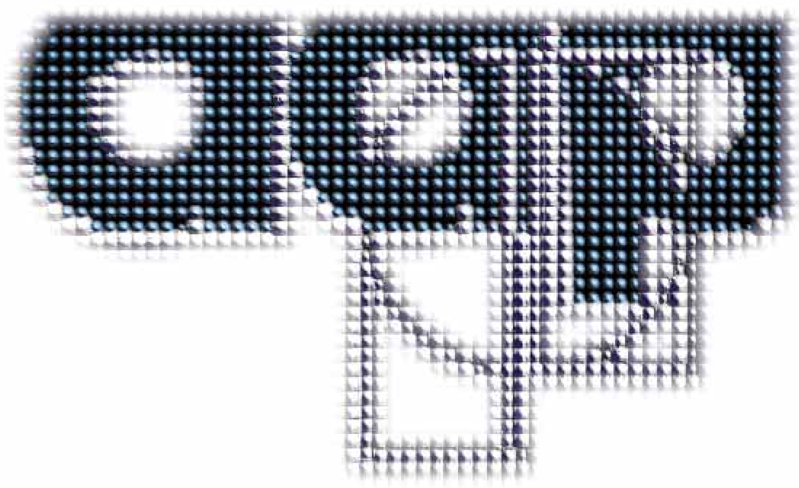
Auditor's Report and Certificate

Based on an audit performed in accordance with our professional duties, the accounting records and the financial statements comply with the legal regulations. The financial statements present, in compliance with required accounting principles, a true and fair view of the net worth, financial position and results of *aap* Implantate AG. The management report is in agreement with the financial statements.

Berlin, January 28, 1999

Dr. Röver & Partner KG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Helmut Schuhmann
Wirtschaftsprüfer



Audit Report and Confirmation

We have duly audited the consolidated financial statements for the year December 31, 1998, and the consolidated pro-forma financial statements for 1996 and 1997 including the cash flow statements. The preparation and the contents of the financial statements are the responsibility of the Management Board of the Company. It is our task to provide an opinion on the basis of the audit conducted by our company whether the consolidated financial statements and the consolidated pro-forma financial statements present a true and fair view of the company's net worth, financial position and results in all essential respects, subject to the premises defined and in accordance with International Accounting Standards (IAS).

We have conducted our audit examination in accordance with generally accepted auditing principles. These principles require a sufficiently detailed audit to permit an auditor's opinion to be given beyond reasonable doubt that the financial statements and pro-forma statements do not contain significant inaccuracies. The audit includes an audit trail with random sampling of the documentary proofs on which the accounting and figures in the consolidated financial statements are based.

Furthermore, it contains an audit of the accounting and valuation methods applied, significant estimates provided by management and an assessment of the general testimony of the consolidated pro-forma financial statements for 1996 and 1997 and the consolidated financial statements for 1998. We are satisfied that our audit examination provides a sufficiently secure and precise foundation for our audit opinion.

The company has prepared these consolidated pro-forma financial statements for 1996 and 1997 and the consolidated financial statements for 1998 and the cash flow statements in accordance with the premises defined in the notes to the accounts and the standards of the International Accounting Standards Committee in force at December 31, 1998. It is our conviction that the consolidated financial statements and the cash flow statement represent a true and faithful picture of the net worth, financial position and results of *aap* Implantate AG for the years concerned in all major respects and that they are in conformance with the standards of the International Accounting Standards Committee.

Berlin, February 12, 1999

Dr. Röver & Partner KG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Helmut Schuhmann
Wirtschaftsprüfer

Consolidated Balance Sheet of *aap* Implantate AG as at December 31, 1998

ASSETS

	DM	DM	Euro	Dec. 31, 1997 DM thousand
A. Fixed assets				
I. Intangible assets				
1. Industrial property rights and similar rights and values	398,471.00		203,734.99	13
2. Goodwill	1.00	398,472.00	0.51	0
II. Tangible assets				
1. Land and buildings	1,609,182.00		822,761.69	1,625
2. Technical plant and machinery	1,511,633.34		772,885.85	518
3. Other plant, office systems and outfitting	1,291,971.85	4,412,787.19	660,574.72	897
III. Financial assets				
1. Equity investments	2,000.00		1,022.58	0
2. Other lendings	231,288.91	233,288.91	118,256.14	187
B. Current assets				
I. Inventories				
1. Raw materials and supplies	1,280,425.86		654,671.34	718
2. Work in process	1,777,805.52		908,977.53	1,001
3. Finished products and merchandise	6,899,877.40	9,958,108.78	3,527,851.30	5,160
II. Receivables and other assets				
1. Trade receivebles	1,293,362.26		661,285.62	1,120
2. Due from affiliated companies	0.00		0.00	0
3. Other assets	1,026,942.94	2,320,305.20	525,067.59	322
III. Checks, cash in hand, Bundesbank, bank and girobank balances		94,586.37	48,361.24	38
C. Deferred charges to operation, prepayments		169,819.91	86,827.54	80
D. Deferred taxes on income		196,000.00	100,213.21	10
		17,783,368.36	9,092,491.86	11,689

EQUITY AND LIABILITIES

	DM	DM	EURO	Dec. 31, 1997 DM thousand
A. Equity				
I. Registrated capital	1,012,000.00		517,427.38	800
II. Capital reserve	4,622,120.00		2,363,252.43	34
III. Revenue reserve				
Statutory reserves	81,565.83		41,703.95	28
Other reserves	508,875.36		260,183.84	0
IV. Minority interest balancing items	-30,621.19		-15,656.37	0
V. Attributable profit	808,908.09	7,002,848.09	413,588.14	1,325
B. Special item		522,867.00	267,337.65	0
C. Provisions				
1. Provisions for taxes	439,662.98		224,796.11	384
2. Other provisions	908,730.00	1,348,392.98	464,626.27	238
D. Liabilities				
1. Liabilities to banks	4,809,542.42		2,459,079.99	5,565
2. Trade payables	1,672,141.53		854,952.39	1,352
3. Liabilities to affiliated companies	0.00		0.00	0
4. Liabilities to associated companies	20,939.34		10,706.11	24
5. Other liabilities	2,405,942.43	8,908,565.72	1,230,138.83	1,938
E. Deferred credits to income, prepayments		694.57	355.13	1
		17,783,368.36	9,092,491.86	11,689

Consolidated Income Statement of *aap* Implantate AG for the Year to December 31, 1998

	DM	DM	EURO	Dec. 31, 1997 DM thousand
1. Sales revenues		10,526,927.42	5,382,332.52	8,338
2. Increase in stocks and finished products and work in process		2,546,135.56	1,301,818.44	1,137
3. Other capitalized own work		223,472.09	114,259.47	375
4. Other operating income		367,152.58	187,722.13	150
5. Materials expense				
a) Expenditure on raw materials and supplies and bought-in goods	-2,512,393.32		-1,284,566.31	-1,681
b) Expenditures on bought-in services	-577,624.31		-295,334.62	-190
		-3,090,017.63		-1,872
6. Personnel expenses				
a) Wages and salaries	-4,727,071.26		-2,416,913.16	-3,020
b) Social security contributions, pensions and welfare expenses	-888,349.55		-454,205.91	-641
		-5,615,420.81		-3,661
7. Depreciation on tangible and intangible fixed assets		-704,111.00	-360,006.24	-487
8. Other operating expenses		-4,102,452.71	-2,097,550.76	-2,905
9. Income from lending and financial assets		13,960.00	7,137.63	0
10. Other interest and similar income		7,934.85	4,057.02	14
11. Other interest and similar expenses		-454,906.25	-232,589.87	-502
12. Profit/loss from ordinary operations		**-281,325.90**	**-143,839.65**	**587**
13. Extraordinary income		157,937.50	80,752.16	111
14. Extraordinary expense		0.00	0.00	-7
15. Net extraordinary income/expense		157,937.50	80,752.16	104
16. Taxes on income		138,511.19	70,819.65	-152
17. Other taxes		481.88	246.38	-1
18. Net profit for the year		**15,604.67**	**7,978.54**	**538**
19. Due to minorities		30,621.19	15,656.37	0
20. Carried-forward profit from the previous year		1,325,123.42	677,524.85	121
21. Shareholder contribution in conjunction with conversion to AG		0.00	0.00	694
22. Allocation to revenue reserves				
a) to the statutory resreves	-53,565.83			-28
b) to other revenue reserves	-508,875.36			0
		-562,441.19	-287,571.61	-28
23. Consolidated attributable profit		808,908.09	413,588.14	1,325

Cash Flow Statement of *aap* Implantate AG as at December 31, 1998

			1998 DM thousand	1997 DM thousand
1.		Net profit/loss for the year	16	538
2.	+	Depreciation on fixed assets	704	487
3.	+	Increase in provisions	726	279
4.	+	Loss on the disposal on the fixed assets	51	0
5.	-	Increase in inventories, trade receivebles and other assets	-4,234	-444
6.	-	Increase/decrease in trade payables and other liabilities	-665	184
7.	+	Increase in special item for investment subsidies	524	0
8.	=	Cash inflow/outflow from current operating activities	-2,878	1,044
9.	-	Outflow of funds for fixed-asset investment (previous year: including shareholder contribution)	-1,062	-1,189
10.	=	Cash inflow/outflow from investing activities	-1,062	-1,189
11.		Inflow from funds from capital increases	4,800	0
12.	-	Increase in lending	-46	-16
13.	+	Inflow of funds from loans taken up	863	163
14.	-	Outflow of funds for the redemption of loans	-1,620	0
15.	=	Cash inflow/outflow from financing activities	3,997	147
16.	+	Funds at the starting of the reporting period	38	36
17.	=	Funds at the close of the reporting period	95	38

Statement of Fixed-Asset Movements of *aap* Implantate AG over the Year to December 31, 1998

	Historical acquisition costs			
	Position at Jan. 1, 1998 DM	Additions DM	Disposals DM	Position at Dec. 31, 1998 DM
B. Fixed assets				
I. Intangible assets				
1. Industrial property rights and similar rights and values	144,585.29	437,234.54	-14,967.47	566,852.36
2. Goodwill	100,000.00	0.00	0.00	100,000.00
	244,585.29	437,234.54	-14,967.47	666,852.36
II. Tangible assets				
1. Land and buildings	1,640,000.00	0.00	0.00	1,640,000.00
2. Technical plant and machinery	4,408,152.27	1,249,112.68	-53,685.00	5,603,579.95
3. Other plant, office systems and outfitting	1,935,225.38	827,091.90	-227,312.43	2,535,004.85
	7,983,377.65	2,076,204.58	-280,997.43	9,778,584.80
III. Financial assets				
1. Shares in affiliated companies	0.00	2,000.00	0.00	2,000.00
2. Other lendings	186,829.91	44,460.00	0.00	231,288.91
	186,828.91	46,460.00	0.00	233,288.91
Total	8,414,791.85	2,559,899.12	-295,964.90	10,678,726.07

	Cumulative depreciation				Book values	
	Position at Jan. 1, 1998 DM	Depreciation in current year DM	Disposals DM	Position at Dec. 31, 1998 DM	Position at Dec. 31, 1998 DM	Position at Dec. 31, 1997 DM
	131,982.29	51,361.54	-14,962.47	168,381.36	398,471.00	12,603.00
	99,999.00	0.00	0.00	99,999.00	1.00	1.00
	231,981.29	51,361.54	-14,962.47	268,380.36	398,472.00	12,604.00
	15,409.00	15,409.00	0.00	30,818.00	1,609,182.00	1,624,591.00
	3,890,152.32	208,500.29	-6,706.00	4,091,946.61	1,511,633.34	517,999.95
	1,037,885.26	428,840.17	-223,692.43	1,243,033.00	1,291,971.85	897,340.12
	4,943,446.58	652,749.46	-230,398.43	5,365,797.61	4,412,787.19	3,039,931.07
	0.00	0.00	0.00	0.00	2,000.00	0.00
	0.00	0.00	0.00	0.00	231,288.91	186,828.91
	0.00	0.00	0.00	0.00	233,288.91	186,828.91
	5,175,427.87	704,111.00	-245,360.90	5,634,177.97	5,044,548.10	3,239,363.98

A. Company information

Name and place of registration
aap Implantate AG, Berlin

Headquarters address
12099 Berlin, Lorenzweg 5

Commercial Register
The Company is registered with the District Court of Berlin-Charlottenburg under reference HRB 64083 and was entered in the Commercial Register on September 10, 1997.

Origin in transformation
The Company is the successor, through a change of name and legal form which took effect as from January 1,1997, to the limited company and partnership *aap* Ahrens, Ahrens & Partner GmbH & Co. Betriebs KG (hereafter referred to as *aap* GmbH & Co. KG).

Objects of the Company
The Company's business objects are the development, manufacture and marketing of implants and surgical tools and the provision of services in the field of precision metalworking and finishing.

The Company has production facilities located in rented premises at Lorenzweg/Berlin-Tempelhof and in its own premises at Spreenhagener Strasse, Markgrafpieske/ Brandenburg. It also has research and development operations based at both sites.

B. General information

1. Accounting basis
The consolidated IAS financial statements of *aap* Implantate AG, Berlin, have been prepared on the basis of the current accounting rules and procedures of the International Accounting Standards Committee (IASC).

aap Implantate AG plans to further increase its registered capital and to offer the new shares to a wide investing public for subscription on a German stock exchange during the 1999 financial year. To this end it has prepared consolidated IAS financial statements in respect of 1996, 1997 and 1998.

In view of the size of the group, the current German accounting regulations do not oblige *aap* Implantate AG to prepare consolidated accounts.

The consolidated IAS financial statements of *aap* Implantate AG for the years to December 31, 1998, 1997 and 1996 have been based on the annual financial statements of the group companies, which were in turn drawn up subject to uniform accounting and valuation principles as required by Germany's Commercial Code (HGB) and stock corporation act (AktG). These were reconciled to the IAS rules at the level of the individual companies. The adjustments for the years up to December 31, 1995 were taken through the balance sheet and included in the profit carried forward at January 01, 1996.

The formats of the balance sheet and income statement are in accordance with IAS rules.

The income statement was prepared on the total-cost basis.

All values have been stated in deutschmarks (DM), the parent company's national currency.

2. Pro-forma AG 1996 accounts
What are known as "pro-forma AG" financial statements have been prepared for *aap* GmbH & Co. KG in respect of the 1996 financial year.

Most importantly, these incorporate the following adjustments:

The sums paid as advance remuneration for the management activity of the principal shareholder and reported as a profit appropriation in the accounts of *aap* GmbH & Co. KG (DM 150 thousand) and the interest paid on loans advanced (DM14 thousand) have been taken through the income statement and treated as expenses.

The shareholders' capital accounts have been broken down and classified as profits or losses and contributions or withdrawals depending on their nature. The latter categories are shown as accounts receivable from or payable to shareholders.

This produces a deficiency of DM 1,371 thousand in the HGB pro-forma AG balance sheet which is not covered by equity but which is covered by undisclosed reserves included under fixed assets and by the contribution of a real estate plot in conjunction with the change in legal status effective from January 1, 1997.

3. 1996 and 1997 IAS consolidated pro-forma accounts

Consolidated pro-forma accounts were prepared for the 1996 and 1997 financial years. During 1996 and 1997 *aap* Implantate AG held 100% of the stock of *aap* America Inc., New Jersey, USA. This subsidiary never commenced trading and was liquidated in at the start of 1998.

The only business transactions which needed consolidating were the provision of a loan by *aap* Implantate AG and a single delivery of goods in 1997.

aap Implants Inc., Plymouth, USA was founded by virtue of an agreement dated April 23, 1998. The parent Company holds 80% of the stock.

For reasons of comparability, the 70% stake in Prothos medizinische und Sportprodukte GmbH held during 1996 was not included in the consolidation sphere since the Company sold this participation in 1997.

C. Consolidation principles

1. Consolidation sphere

	Size of stake in %
aap Implantate AG, Berlin	Parent company
aap Implants Inc., Plymouth, USA	80

2. Closing date for consolidated financial statements

The consolidated companies both take the calendar year as their financial year. The consolidated statements have accordingly been prepared as at December 31, 1998.

3. Currency translation

The financial statements for the consolidated subsidiary have been translated into deutschmarks in line with IAS 21 and the functional currency concept.

Since the subsidiary company is an integral sub-unit of *aap* Implantate AG in financial, operating and organizational terms, its functional currency is the same as the parent company's national currency.

Accordingly, monetary headings have been translated at the accounting date exchange rate rather than at historic rates.

For reasons of economy, inventory components have been translated at the exchange rate applying on the accounting date.

Expenses and income which do not relate to monetary account headings have been translated at the corresponding historic exchange rate or the accounting date exchange rate, and the remaining expenses and income at average rates.

Differences arising from currency translation have been incorporated in the income statement.

4. Capital consolidation
There was no need to consolidate capital relationships since the consolidated subsidiary did not possess any equity capital at the date of its first consolidation, and in the absence of acquisition costs the parent company did not report a book value for the participation.

5. Debt consolidation
Intra-group receivables and payables were netted off. Netting differences arising during the period under report were included in the income statement.

6. Profit consolidation
For the purposes of profit consolidation, intra-group sales and intra-group income and expenses were netted off. Inter-company profits were eliminated.

D. Accounting and valuation principles

The financial statements of the consolidated companies have been prepared in accordance with uniform principles of presentation and valuation.

Intangible assets were valued at their cost of acquisition less regular depreciation.

Tangible fixed assets have been valued at their cost of acquisition or manufacture, and the value of tangible assets with a limited useful life has been reduced by regular depreciation.

Interest paid on borrowings is not capitalized.

Non-real-estate assets with a purchase cost of up to DM 800.00 are written off in full in the year of accrual.

Financial assets are carried at cost of acquisition or updated book value.

The items included in the inventories heading are valued either at cost of acquisition or manufacture, or the lower of cost or market on the balance sheet date.

Raw materials and supplies were valued at procurement cost.

Work in process and finished products have been valued at cost of manufacture. This measure includes the assignable direct costs plus appropriate portions of the essential production overheads. These include materials and production overheads and production-related administrative costs, as well as straight-line depreciation on production plant.

Interest paid on borrowings is not capitalized.

The strict principle of valuation at the lower of cost or market was observed.

Receivables and other assets are carried at their nominal value or at their realizable value at the accounting date if lower. General credit risk is accommodated through a global bad debt provision amounting to 3% of the stock of non-specifically-adjusted receivables.

Received investment grant aid is entered on the liabilities side as a "special item in respect of fixed-asset investment subsidies". This is liquidated in the income statement on a straight-line basis reflecting the service life of the subsidized assets.

Provisions have been made to take appropriate account of the foreseeable risks and reported liabilities. The provisions have been set at levels commensurate with prudent commercial judgement.

Outstanding liabilities have been valued at their repayment value.

Foreign currency liabilities have been translated at their repayment value at origination or at the selling rate applying on accounting date if higher.

E. Notes to the balance sheet

I. Fixed assets

The table of fixed-asset movements shows the changes during the period.

1. Intangible assets

From their historic acquisition cost, the value of intangible assets is depreciated on a straight-line basis pro rata temporis.

The following service life assumptions are applied:

	Years
Industrial property rights and similar rights and values	5
Goodwill	15

2. Development costs

Development costs of DM 244 thousand were booked as expense during the period under report.

3. Tangible fixed assets

From their historic acquisition or manufacturing cost, the value of tangible assets is depreciated on a straight-line basis.

The following average lives apply:

	Years
Land and buildings	50
Technical plant and machinery	
-Machinery	5
-Essential machine tooling	2
Other plant, factory and office systems and outfitting	
-Factory equipment	5
-Hardware	5
-Tenants	10
-Improvements	5
-Other factory and office outfitting	5
-Sample cases	5

There were no exceptional write-downs or revaluations during the year.

The book value of leased tangible assets was DM 1,113 thousand at December 31, 1998.

4. Financial assets

	DM thousand	%
Shares in affiliated companies		
aap Implants Inc., Plymouth, USA	0	80
Equity investments		
Cybernetic Vision Aktiengesellschaft		
Health Monitoring Technologies, Berlin	2	5
Other lending	231	
	233	

II. Current assets

1. Other assets

	1998 DM thousand	1997 DM thousand
Due from the tax authority	326	253
Outstanding investment grants receivable	550	0
Balances with creditors	74	29
Due from employees, loans, advances of pay	60	22
Other	17	18
	1,027	**322**

2. Deferred charges to operation, prepayments

This heading includes discounts totaling DM 40 thousand.

3. Deferred taxes on income

This deferral item is short-term and is composed as follows:

	1998 DM thousand	1997 DM thousand
Deferred tax set-off entitlement on the carried-forward loss of *aap* Implants Inc., Plymouth, USA	86	5
Deferred tax set-off entitlement from the elimination of inter-company profits	110	5
	196	**10**

The deferred tax entitlement on the carried-forward loss of *aap* Implants Inc., Plymouth, USA was calculated on the assumption of an average tax rates of 35%. The Company expects to make profits in the years to come when it will take advantage of its tax-allowable business start-up losses of DM 234 thousand.

The deferred tax credit arising from consolidation was calculated on the basis of an average tax rate for the group of 50%.

III. Equity

The parent company's registered capital was DM 1,012,000.00 at December 31,1998, divided into 202,400 unit bearer shares. The nominal value of each share was DM 5.00.

The Supervisory Board met on January 15, 1998 and approved the Managing Board's resolution of January 14, 1998 to undertake a DM 100,000.00 capital increase from authorized capital to a then new total of DM 900,000.00.

This measure was recorded in the Commercial Register on February 23, 1998. The capital increase was implemented through the issue of 20,000 bearer shares with a nominal value of DM 5.00.

Payment for the new shares was received during February 1998, and totaled DM 1,125,000.00 including premium. By agreement, the sum of DM 375,000.00 received as a loan in December 1997 was transferred to the capital reserve following the recording of the capital increase in the Commercial Register.

By virtue of a Managing Board resolution of May 20, 1998, affirmed by the Supervisory Board on May 28 and June 02, 1998, the Company's registered capital was raised to DM 920,000.00 by the issue of a further 4,000 bearer shares with a nominal value of DM 5.00. This measure was recorded in the Commercial Register on June 16, 1998 and the payment in respect of the new shares of DM 280,000.00 including premium was received on June 02, 1998.

A further Managing Board resolution of August 13, 1998, affirmed by the Supervisory Board on August 13, 1998, authorized an increase of the Company's re-gistered capital by DM 92,000.00 to DM 1,012,000.00. This capital increase was implemented through the issue of 18,400 unit bearer shares. This measure was recorded in the Commercial Register on October 01, 1998 and the payment in respect of the new shares of DM 3,000,120.00 (including premium) was received on August 25, 26 and 28, 1998.

The Company's registered capital therefore evolved as follows over the year:

	DM
Position at Jan. 1, 1998	800,000.00
Capital increase Jan. 15, 1998	100,000.00
Capital increase May 20, 1998	20,000.00
Capital increase August 13, 1998	92,000.00
	1,012,000.00

The Company's capital reserve evolved as follows over the year:

		DM
Position at	January 1, 1998	34,000.00
Capital increase	January 15, 1998	1,025,000.00
Deposit	February 23, 1998	375,000.00
Capital increase	May 20, 1998	280,000.00
Capital increase	August 13, 1998	2,908,120.00
		4,622,120.00

One-twentieth of the parent company's annual net profit on the HGB basis, after offsetting the brought-forward loss, was allocated to the statutory reserve as required by Article 150 (2) of Germany's stock corporation act (AktG). This accordingly stood at DM 81,565.83 at the end of the year and, taken together with the capital reserve, now exceeds one-tenth of the Company's registered capital.

Table of reserves as at December 31, 1998

	Position at Jan. 1, 1998 DM thousand	Allocation from annual profit DM thousand	Endowment during year DM thousand	Position at Dec. 31, 1998 DM thousand
I. Capital reserve	34	0	4,588	4,622
II. Revenue reserves				
1. Statutory reserves	28	53	0	81
2. Other revenue reserves	0	509	0	509
	62	**562**	**4,588**	**5,212**

In compliance with the first sub-sentence of Article 24 (1) 1 of the Company's statutes, the parent company's Managing Board and Supervisory Board transferred 50% of the 1998 commercial balance sheet (HGB) net profit remaining after the cancellation of the loss-carryover and the allocation to the statutory reserve, to the Company's other revenue reserves.

In their invitation to the parent company Annual General Meeting scheduled for February 22, 1999, the Managing Board and Supervisory Board proposed allocating the HGB attributable profit of DM 508,875.36 to the other revenue reserves.

IV. Provisions

1. Provisions for tax

	1998 DM thousand	1997 DM thousand
Deferred 1995 income tax offset entitlement	-128	-128
Provision for deferred 1996 income tax liability	356	356
Provision for deferred 1997 income tax liability	159	156
HGB provision for 1998 income tax liability	1,525	0
Deferred 1998 income tax offset entitlement	-1,472	0
	440	**384**

The provision for deferred taxes on income needed to be made to cover the timing differences between the reported values of the HGB and IAS financial statements of *aap* Implantate AG's unconsolidated financial statements for 1995 through 1998.

The municipal trade earnings tax calculation started from the IAS net profit and added or deducted the relevant tax factors to identify the relevant earnings base for assessing this tax. Depending on the increase in the tax factor between 1995 and 1998, the resulting municipal tax ratio ranged from 15% in 1995 to 19.5% in 1998.

The deferred corporation tax calculation assumed a tax rate of 30% on distributions since irrespective of the planned or approved distributions, the retention of earnings generates a deferred corporation tax relief entitlement to the value of the difference between the distribution and retention rates which on its own falls within the scope of the Company's discretion.

Provision was also made for the solidarity surcharge levied at the rate of 7.5% (1997: 5,5%) on the calculated corporation tax liability.

2. Other provisions

Other provisions evolved as follows during the year:

	Position at Dec. 31, 1998 DM thousand	Position at Dec. 31, 1997 DM thousand
Staff holiday entitlements	176	96
Annual accountancy and audit costs	68	30
Bonus obligations	115	60
Trade association	25	25
Performance-related bonus	123	25
Commission obligations	60	0
Outstanding invoices	52	0
Litigation costs and risks	20	0
Disabled employment equalization levy	0	2
Profit-related remuneration of dormant shareholders	20	0
Other risks	250	0
	909	**238**

V. Liabilities

The following table shows the residual term of the consolidated liabilities broken down by balance sheet headings.

	Total value	Repayable in		
	Dec. 31, 1998	Up to 1 year	1 to 5 years	Over 5 years
	DM thousand	DM thousand	DM thousand	DM thousand
Liabilities to banks	4,809	1,966	2,413	430
Trade payables	1,672	1,672	0	0
Liabilities to associated companies	21	21	0	0
Other liabilities				
– in relation to social security	144	144	0	0
– in relation to taxation	210	210	0	0
– Leasing liabilities	1,154	693	461	0
– Sundry liabilities	899	443	228	228
	8,909	**5,149**	**3,102**	**658**

The reported liabilities to banks are secured to the value of DM 2,300 thousand through mortgages and the assignment as security of various machines and receivables.

F. Notes to the income statement

I. Sales revenues

	1998	1997
	DM thousand	DM thousand
Sales revenues in the		
Federal Republic of Germany		
Vat. rate 15%/16%	4,390	1,733
Vat. rate 7%	2,276	3,705
	6,666	5,438
Sales revenues in the rest of the		
European Union	854	774
Sales revenues in the rest of world	3,242	2,298
Revenue deductions	-235	-172
	10,527	**8,338**

II. Other operating income

	1998 DM thousand	1997 DM thousand
Private Car usage	86	55
Income from forgiveness of debt	70	0
Income from unwinding of contracts	47	0
Income from writing back provisions	39	1
Exchange rate gains	43	8
Income from liquidating the investment subsidy special item	27	0
Rent income	12	0
Income from management services	0	18
Income from the sale of assets	0	27
Other	43	41
	367	**150**

III. Depreciation

	1998 DM thousand	1997 DM thousand
Depreciation on intangible fixed assets	51	6
Depreciation on tangible assets of which on low-ticket items of less than DM 800.00: DM 47 thousand	653	481
	704	**487**

IV. Other operating expenses

	1998 DM thousand	1997 DM thousand
Advertising and travel costs	919	497
Accommondation costs	660	647
Consultancy costs	344	206
Leasing	265	190
Office consumables, phone, fax, postage	247	194
Sales commission	202	190
Shipping costs, packaging materials	161	91
Vehicle costs	129	167
Repairs and maintenance	105	94
Insurance, contributions, levys	100	62
Losses and write-downs on receivables	75	25
Other costs	895	542
	4,102	**2,905**

V. Net financial expense

	1998 DM thousand	1997 DM thousand
Income from other lending	14	0
Other interest and similar income	8	15
Other interest and similar expense		
– Interest on long-term credit liabilities	-300	-418
– Interest on short-term bank liabilities	-52	-40
– Interest due to dormant shareholders	-61	-2
– Liquidation of financing costs	-27	-7
– Other interest expenses	-15	-35
	-455	-502
	-433	**-487**

VI. Exchange rate differences

The currency gains and losses which were offset during the period under report and taken to the income statement were:

	1998 DM thousand	1997 DM thousand
Income from exchange rate variances	43	8
Expense from exchange rate variances	21	3

VII. Net exceptional income

This heading includes government return-to-work subsidies from the Labor Office, amounting to DM 158 thousand (1997: DM 111 thousand).

▶ G. Information on developments since the end of the financial year

The Company plans to further increase its registered capital and to offer the new shares to a wide investing public for subscription on a German stock exchange during the 1999 financial year. The necessary reparations for the initial public offering, such as selecting the banks for the placement syndicate and preparing a prospectus, are already virtually complete.

▶ H. Other information

Breakdown of the workforce by groups:

	1998	1997
Average employee total:	82	48
of which: female	12	6
male	70	42
hourly paid	49	31
Salaried	33	17

The sole member of the Company's Managing Board during the year was Dipl.-Ing. Uwe Ahrens (MSc Eng.).

The Company has granted its sole executive director Dipl.-Ing. Uwe Ahrens a deferment on payment of its entitlement to a purchase price of DM 28,000.00 for the assignment of its shares in Prothos medizinische und Sportprodukte GmbH. Incremental interest of 5% is payable on this amount. The deferment may be revoked subject to three months notice to the year end.

The following were members of the Supervisory Board during the year under report:

To August 12, 1998

Eckardt Manske, MSc (Math.), Berlin
(Chairman)

Lothar Just, Berlin
chartered auditor and tax consultant
(Deputy Chairman)

Dr. Heinz Helge Schauwecker, Berlin
head physician and senior lecturer

The Supervisory Board received total remuneration of DM 66,000.00 in the year.

From August 13, 1998

Lothar Just, Berlin
chartered auditor and tax consultant
(Chairman)

Klaus Kosakowski, MSc (Econ)
Berlin
(Deputy Chairman)

Dieter Borrmann, MSc (Eng.)
Berlin

Prof. Dr. Dr. h.c. Horst Cotta,
Heidelberg

Susanne Ropertz, MSc (Econ)
Bonn

Dr. Heinz Helge Schauwecker,
Berlin
head physician and senior lecturer

Under the terms of an agreement dated April 23, 1998, the Company was co-founder of *aap* Implants Inc. in Plymouth, Massachusetts, USA. The ownership structure of this company is as follows:

aap Implantate AG	80 %
Joachim Staub	10 %
Wayne R. Knupp	5 %
Ellen J. Knupp	5 %
	100 %

Berlin, January 29, 1999

Management Board

Uwe Ahrens, MSc (Eng.)

Bruke Seyoum Alemu, MSc (Eng.)

Joachim Staub, MSc (Eng.)

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