aap Implantate AG

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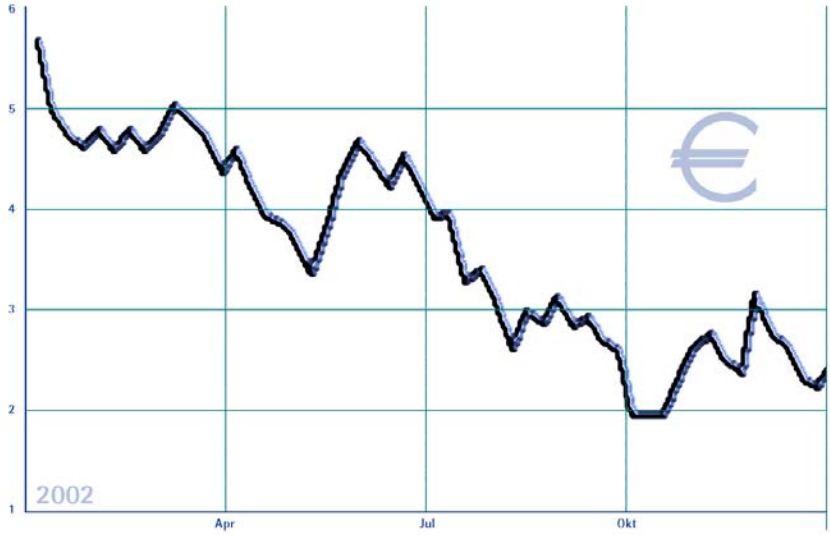
Annual Report 2002

Content

Share and stock market

Share price trend



Sadly, *aap* stock did not share in *aap*'s positive corporate development, and we were unable to buck the trend of a difficult worldwide stock market environment over the past 12 months, for Germany's DAX index, too, it was the third year of losses in succession. The share price was also burdened by the catastrophic state of the financial market and the poor state of the economy, especially in Germany.

In the course of 2002, the share price took a 56% drop, from a high watermark of € 5.70 early in January to a low for the year of € 1.76 in mid-October from which, however, it was able to recover slightly by the year's end. Yet the *aap* share's unsatisfactory performance was, for the most part, better than that of the NEMAX All-Share index.

Finance

Consolidated development of sales revenues and results

The sales and earnings trend in fiscal 2002 was positive, with sales revenues up € 1.4 million to € 13.3 million (previous year: € 11.9 million), which corresponds to a relative increase of around 11%.

This marked increase in sales revenues was due mainly to the expansion of business activity in the Asian market. Further increases were achieved in the African and European markets, while German sales at € 9.2 million were roughly on a par with the previous year.

By product, sales growth was mainly in the osteosynthesis unit. In endoprosthetics, too, growth was achieved. Sales revenues from orthobiologics were up on the year, but still of minor importance in relation to consolidated sales. The Management anticipates a marked expansion in orthobiological business in fiscal 2003, driven by Cerabone® and Ostim®, both products for which approvals have already been granted. In the R&D services unit, the HJS knee development contract was billed, but the resulting contribution toward 2002 sales and earnings was of minor importance due to booking in accordance with the IAS percentage of completion method in previous years. No other R&D services were provided for external prinicipals in the year under review.

Total operating performance was up markedly on the year, too, to € 14.770 million from € 12.156 million even though internally produced and capitalized assets at € 1.514 million were € 378,000 below the previous year's € 1.892 million and there was a € 73,000 drop in inventories (previous year: € 1.712 million).

EBITDA including stock options was increased to € 1.03 million (previous year: –€ 1.97 million). After taking into account high acquisition-related depreciations totaling € 1.461 million and stock options booked as expenditure totaling € 579,000, EBIT improved markedly by € 2.834 million to –€ 1.853 million (previous year: –€ 4.618 million). EBITDA excluding stock options improved to € 1.6 million (previous year: –€ 1.171 million). EBIT before acquisition-related depreciations and stock options was € 188,000, or € 2.638 million above the previous year's –€ 2.447 million.

Taking into account special factors (acquisition-related depreciations and stock options), the DVFA/SG result in the review period was, at –€ 4.429 million, above the previous year's –€ 3.372 million. DVFA/SG earnings per share were –€ 0.93 (previous year: –€ 0.71), while DVFA/SG cash earnings were down on the year to –€ 1.583 million (previous year: –€ 777,000).

The DVFA/SG consolidated result before special factors in the review period was –€ 3.066 million, below the previous year's –€ 1.896 million. DVFA/SG earnings per share excluding the aforementioned special factors were –€ 0.64 (previous year: –€ 0.40). DVFA/SG cash earnings before special effects deteriorated in the review period to –€ 1.680 million (previous year: – € 737,000). This decline on the year, which is partly reflected in the key figures, is due to a reduction in deferred income tax credits.

The marked improvement in operating results was due to restructuring measures implemented, to integration of corporate acquisitions and to the creation of a uniform sales force throughout the group. The cost reduction program initiated at the end of 2001 also accomplished continuous successes. Significant reductions in personnel expenditure also went ahead according to schedule. The materials expenditure quota was reduced to approx. 30.7% from 34.4%. Other operating expenditure was down too in relation to total operating performance.

Despite this positive turning-point (we achieved our double-digit sales growth objective), other planned sales failed to come about. This was due above all to U.S. business falling below expectations, to delays in marketing orthobiological products, to license sales that failed to materialize, and to planned large orders by exclusive sales partners that failed to come about. On the income side too we failed to achieve our forecast of at least breaking even. Reasons for failure to achieve profitability were sales growth in only low double digits and delays in product launches. The result was burdened further by the effects of winding up the U.S. subsidiary, by provisions for the planned share listing, by writedowns on internally produced and capitalized assets due to changed development project priorities and by depreciations on trade receivables at GEOT GmbH.

Despite promising sales and earnings trends, the *aap* Group's liquidity position was tight. DVFA/SG cash earnings continued to be negative, due mainly to the high level of financial requirements for new and ongoing product development. Expenditure on fixed assets, in

contrast, was down on the year. The ongoing high borrowing requirement led to a marked deterioration of the financial result to –€ 1.255 million (previous year: –€ 916,000) that was also influenced by higher negative earnings contributions from affiliated companies that were carried in the balance sheet at equity (2002: –€ 134,000 against 2001: –€ 69,000).

Consolidated balance sheet development

Balance sheet structure changed only slightly compared with Dec. 31, 2001. Fixed assets were reduced by planned depreciation. Investments in tangible fixed assets totaling € 2.996 million (previous year: € 2.773 million) were essentially a license to manufacture and sell an artificial knee joint and capitalization of development costs totaling € 1.090 million (previous year: € 1.587 million). Inventories were reduced according to schedule by € 987,000 in connection with product portfolio streamlining. Trade receivables were down € 2.836 million due to billing of the development contract and acquisition of the sales license for the implant that was developed in-house. The main other asset item is a guaranty claim against contributing shareholders in the Mebio/Coripharm group of companies.

The *aap* Group's equity ratio continues to be over 50% (previous year: 55%). Borrowed capital was down on the year as a result of scheduled repayment. The increase in provisions is due to the cost of stock market listing shares issued by the contributing shareholders in the Mebio/Coripharm group of companies.

Sales and results development at aap Implantate AG

The financial statements for *aap* Implantate AG, based on the statutory accounting requirements of the German Commercial Code, show an increase in sales revenues of approx. 51% to € 10.783 million (previous year: € 7.122 million) and a € 4.512 million improvement in operating result to € 488,000. The net loss for the year was € 122,000 (previous year: –€ 4.448 million).

The main factor influencing this positive development was the billing of several years' research and development work on a new knee implant. But for the sales and results contribution made by this order, sales revenues would have been € 7.757 million and the operating result after taking capitalized stock options totaling € 579,000 into account would have been –€ 1.459 million, or

€ 2.565 million up on the previous year's –€ 4.024 million. This marked improvement in result was due essentially to the restructuring and cost reduction program initiated by the management at the end of 2001 that led, in particular, to a reduction in payroll expenditure. Other operating expenditure was down markedly on the year in relation to total operating performance too, although one-off expenditure of € 1.545 million on strategic realignment of business in the United States and the proposed winding-up of *aap*'s U.S. sales subsidiary had to be taken into account.

Balance sheet development at aap Implantate AG

Balance sheet structure changed only slightly compared with Dec. 31, 2001. Fixed assets were up € 1.348 million. Investment in fixed assets totaling € 1.198 million consisted mainly of a license to manufacture and sell an artificial knee joint. In the year under review, inventories were reduced to € 7.295 million (previous year: € 8.241 million). Loans to affiliated and associated undertakings were down € 1.181 million on the year to € 607,000. An important item under other assets is the guaranty claim against the contributing shareholders in the Mebio/Coripharm group of companies.

aap Implantate AG's equity quota is 46% (previous year: 45%). The increase in provisions is due to the cost of stock market listing shares issued by the contributing shareholders in the Mebio/Coripharm group of companies.

Subsidiaries
Mebio, Corimed and Coripharm

These *aap* subsidiaries are active in the medical and biomedical biomaterials markets and in research, development and sales of endoprosthetics, bone replacements and bone cement. Orthobiology (biological implants) is taken forward in these companies as a third *aap* core competence. Via these companies and shareholdings, *aap* has at its disposal additional innovative products, a research and development team with many years of experience, a total of 17 patents in the above-mentioned business fields and an international network of recognized research scientists and practicing physicians.

The situation at aap Implants Inc.

aap's business model for working the U.S. market was redrafted at the end of the business year. The strategic realignment of sales activity in the United States provides for a network of dealers to ensure optimal geographic coverage of this high-growth market. One independent sales partner has already been enlisted, thereby laying the groundwork for marketing aap's trauma products. In fiscal 2003, other sales partners are to be canvassed in addition to the existing, Florida-based dealer. Amongst other moves, *aap* will be trying to line up Smith & Nephew as a further partner for the U.S. market.

From mid-2003, *aap* Implants Inc. is no longer to conduct operative business. The aim is to wind up the U.S. subsidiary entirely in the first half of 2003. By mid-year *aap* will decide whether the corporation is to continue as a sleeping company or to be shut down entirely. All the necessary measures were initiated in 2002. As part of the winding-up operation, product shipments have already been reversed, and all liabilities owed to the parent company were written off in 2002. A part of the inventories held by *aap* Implants Inc. has already been handed over to the new sales partner.

Strategic participation
OSARTIS

The business model of OSARTIS is at present based mainly on successful marketing of the bone replacement material Ostim®. *aap* anticipates a high sales growth potential from this product, given that OSARTIS has already signed various sales contracts to market Ostim® in Europe. *aap* expects OSARTIS to break even in 2004.

Strategic participation
GEOT (Gesellschaft für Elektro-Osteotherapie mbH)

Gesellschaft für Elektro-Osteotherapie mbH has developed a method of encouraging and accelerating bone healing: magnetically induced, invasive electro-osteostimulation. Elektro-osteostimulation makes use of the therapeutic potential of electric and magnetic fields to revitalize degenerative bone tissue. The process has been approved by Germany's Federal

Committee of Physicians and Health Insurers and included in the register of approved aids and appliances. CE approval of the entire GEOT product range, granted in the year under review, opens up for *aap* a market with a highly promising future: that of invasive electro-medicine.

Thanks to their modular concept, GEOT universal carriers can easily be combined with all of the *aap* osteosynthesis screws. The cement-free hip prosthesis that is under development at *aap* is suitable for use in conjunction with electro-osteostimulation too. Some 340,000 prosthesis systems are implanted each year in Germany alone. That is why *aap* as GEOT's sales partner sees here an exceptionally high market potential. An additional field salesman has been hired to pursue aggressive marketing of GEOT products. *aap* expects GEOT to reach break-even point in 2003.

Employees

The number of employees at *aap* Implantate AG on Dec. 31, 2001 was 86, of whom 74 were full-time, 8 part-time and 4 temporary (previous year: 86, of whom 76 were full-time, 7 part-time and 3 temporary). As of Dec. 31, 2002, the *aap* group of companies employed 108 staff, of whom 92 were full-time, 11 part-time and 5 temporary (previous year: 108 employees, of whom 94 were full-time, 10 part-time and 4 temporary).

In keeping with the company's tradition, *aap* continued in 2002 to train staff in significant numbers, with 16% of its employees (14) being trainees. This large number of trainees, mainly in production, thereby enables the company at any time to meet future employee requirements from a large pool of highly qualified up and coming youngsters.

Where personnel are concerned, the restructuring program has been largely completed. After further reductions, the aap group reached a payroll level of 105 employees at the beginning of 2003.

Products, markets and sales

Business units at aap Implantate AG

aap's main fields of business in fiscal 2002 were osteosynthesis and the development of implants for outside principals as a service provider. Their share of total sales amounted to 62.1% (previous year: 80.3%) and 28.1% (previous year: 0%) respectively. Endoprosthetics, which ranked second for sales in 2001, was down to 9.8% in 2002 (previous year: 19.7%). This decline or, alternatively, the enormous growth in R&D business is due in particular to the realization of an order for HJS-Gelenk System GmbH. In 1999, *aap* signed with HJS-Gelenk System GmbH a € 3.026 million contract to develop marketable knee implants and operating equipment on the basis of patents held and applied for by HJS. This development contract consisted of 44 separate but partially overlapping stages. In the year under review, *aap* was able to complete nearly all the project phases with the exception of securing approvals in the United States, Japan and China for the implant developed. On the basis of a 99% completion level and an agreement on extension of payment, HJS-Gelenk System GmbH has accordingly declared acceptance of the development contract. Having realized the contract in 2002, *aap* sales shifted markedly toward the R&D services unit and away from endoprosthetics.

The largest proportion of sales revenues totaling € 10.8 million, 70.5% (previous year: 68.2%) was earned in Germany. Sales in Germany totaled € 7.6 million and were therefore approx. 57% higher than the previous year's € 4.9 million. Other sales were in the rest of Europe, 4.3% (previous year: 7.9%), Asia, 22.4% (previous year: 17.6%), the Americas, 2.5% (previous year: 4.7%), and Africa, 0.2% (previous year: 1.6%). Highest year-on-year sales growth at 92.3% was achieved in Asia.

As of Dec. 31, 2002, orders in hand totaled € 177,000 (previous year: € 153,000). As the company supplies its customers on a round-the-clock basis, its order backlog is in principle characterized by relatively low figures.

Business units in the aap Group

Osteosynthesis and endoprosthetics continued in 2002 to be the *aap* Group's main fields of business. The osteosynthesis unit accounted for 52.9% (previous year: 49.3%) of total sales revenue, while endoprosthetics accounted for 44.5% (previous year: 47.5%). The other two business fields, R&D services and orthobiology, did not yet account for significant sales shares, totaling 1.7% (previous year: 3.1%) and 0.9% (previous year: 0.1%) respectively.

The largest proportion of consolidated sales revenues totaling € 13.3 million, 69.1% (previous year: 77.3%), was earned in Germany. The breakdown of foreign sales revenues was: Europe 6.8% (previous year: 6.2%), Asia 18.1% (previous year: 10.5%), the Americas 5.8% (previous year: 5.0%), and Africa 0.2% (previous year: 0.9%).

Sales and marketing activities

The second half of 2002 was very much predominated by preparations for the market launch of the ÆQUOS® anatomic knee prosthesis. Following the initial presentation of ÆQUOS® at the German Orthopedic Congress in Berlin, the sales launch is planned for 2003. Marketing measures are already underway. Accompanied by intensive product and sales training courses, they are based on the contract signed with HJS-Gelenk System GmbH in the fourth quarter of the year under review on an exclusive license to manufacture and sell the ÆQUOS® artificial knee joint and instrument sets for human and animals implants in Germany, the remainder of the European Union, European Economic Area member-states and China and Japan.

The shoulder competence area has been extended by the market launch of a modified acromioclavicular plate for lateral fractures.

In our key Asian market, China, we have made strenuous efforts to ensure that our products are available for delivery. As a result, a smooth supply was guaranteed even to the country's largest, 700-bed orthopedic hospital. We were also able to underscore the strategic significance of China in our international sales strategy by attending the first Chinese trauma congress in Shenzhen, South China, followed by a lecture tour.

As part of the reorganization of sales structure in the United States a first sales partner has started work on marketing *aap* trauma products. This largest orthopedic market in the world is to be worked aggressively in 2003 by offering a wider range of products including DHS and cannulated screw systems.

A keynote of 2002 was the wide range of national and international trade fairs and congresses in which *aap* took part. The world's largest orthopedics and trauma congress, the AAOS congress in Dallas, Texas, opened up new and interesting contacts with opinion formers in the United States and other foreign markets. An osteosynthesis workshop for orthopedic surgeons held at the South German Orthopedics Congress in Baden-Baden built a bridge between accident and orthopedic surgeons. The highlight among congresses for the industry was the annual congress of German Accident Surgeons (DGU), while at Medica 2002 in Düsseldorf we addressed, as we do every year, the wide range of international traders.

In the osteosynthesis unit, sales of the humerus fixature plate were above plan. After initial good experiences in selling power drills and saws, advertising for the full MicroAire power tool range was commenced.

In the market for bone cement and cementing techniques, the 2002 business year was marked by increasingly aggressive pressure of competition. To ensure continued positive growth rates in this unit, Mebio signed in the third quarter a sales agreement with Schering Plough to sell Palacos® R cements in Germany, Austria and Italy.

To fulfill the ambitious expectations placed in the orthiological products Cerabone® und Ostim® manufactured by *aap* subsidiaries Coripharm and OSARTIS, marketing and sales activities were intensified in connection with the market launch and with field sales staff training. In 2003, *aap* hopes to achieve significant sales of these products by means of intensive marketing. To make optimal use of the prospects for these products, *aap* is concentrating on enlisting further sales partners in Europe.

As part of the market launch of EASYMIX® in Europe, sales were extended from a number of Schering Plough branches to additional sales dealers in Italy and Russia.

Research & Development

Osteosynthesis

All components of the modular Biorigid Femur System (BFS) are now in series production. So the osteosynthesis market now has at its disposal both the BNT System for the lower leg and an innovative nail system for the thigh.

At the same time the cannulated screw portfolio has been meaningfully added to by the start of series production of screws with a diameter of 5.8 and 6.5 millimeters.

Making a four-hole version of the AcroPlate® available for operative provision in the acromioclavicular joint area is an example of continuous further development, constant extension of indication and swift time to market of small implants in the osteosynthesis unit.

In fiscal 2002, then, aap's osteosynthesis and traumatology product range continued to be extended.

Endoprosthetics

Preparations for reorganization of the endoprosthetics range have been taken further forward with a view to optimizing and meaningfully extending the *aap* Group's range of endoprosthetic products and to completing projects that will complete the range of endoprosthetic implants. This means cemented and non-cemented implants for the hip, knee and shoulder joint areas.

Completion of current developments in this connection, such as a unilateral (monocondylar) surface replacement for the knee joint for use in minimally invasive operating techniques hip joint shafts fixed without using cement, is scheduled for July 2003.

After securing approval in the first half of 2002 and signing a sales agreement for the ÆQUOS® knee endoprosthesis that was developed under contract for HJS-Gelenksystem GmbH, production of the first two systems of this highly innovative implant began. Having prepared for and made available the high-precision production and measuring technology required to realize the

anatomical surfaces of the ÆQUOS® knee prosthesis, *aap* has at its disposal a highly promising development instrument for future implant generations.

For the EASYMIX® cementing system, prototypes of new vacuum pumps and guns for long-term tests were developed. Prototype cartridges and packaging for a new mixing system were also produced.

Orthobiology

The entire technical documentation needed to secure approval of a new bone replacement material was drawn up. Data was compiled and evaluated for the necessary clinical surveys too.

For the Ostim® hydroxylapatite paste, clinical indications are in the process of being drawn up in collaboration with orthopedic and accident surgeons.

Production and procurement

The main objective of the ongoing restructuring measures begun last year in the production area was to boost productivity. Measures undertaken in this connection were permanent optimizing of production processes (greater responsibility in production cells, optimizing of batch sizes, and demand-oriented production and inventory management) and implementing a consistent streamlining of the product portfolio (reduction in products with long changeover times).

To improve handling and end-to-end compatibility of different operating techniques, test runs of individual components of our hip systems were produced that support both cemented and cement-free techniques and different combinations of materials.

The second half was very much predominated by preparations for series production of the ÆQUOS® knee prosthesis, which presupposed production at the highest technology and quality levels.

A four-hole plate was added to acromioclavicular plate production to extend coverage to include lateral clavicular fracture indications.

With strict checks on all purchase requisitions, inventory control (quantity ordered to cover a maximum 3 months) and the signing of framework agreements providing for *aap* calldowns even of small unit numbers at short notice, costs were reduced further and procurement volumes optimized.

Quality management and environmental management

After the annual audit by Dekra ITS Certification Services GmbH in the first quarter of 2002 in which the quality management system was given an extremely positive rating, the changeover to the new ISO 9001:2000 quality management system and the ISO 14001 environmental management system was taken forward.

Jointly with Dekra ITS Certification Services GmbH, it is planned to check the effectiveness of the quality management system by means of an audit in the first quarter of 2003.

The application to Dekra ITS Certification Services GmbH to extend CE certification to knee endoprostheses, which was also made in the first quarter of 2002, was completed successfully at the beginning of the second quarter.

Product approvals for the Biorigid Nail™ Femur in the U.S. market were granted in the third quarter. New, additional, 5.8 mm and 6.5 mm diameter cannulated screws specially developed for the U.S. and Japanese markets were approved by the U.S. Food and Drug Administration (FDA) in the fourth quarter.

The approval application for the new Trauma Shoulder System concept was submitted to the FDA at the end of the first quarter of 2002, but in view of the product's complexity, approval cannot be anticipated before the second quarter of 2003 at the earliest.

After successful CE approval in the second quarter of 2002, the compilation of documentation required for U.S. approval of the new knee concept was commenced. Approval cannot be expected before the end of the second quarter of 2003 at the earliest.

In the fourth quarter, preparations began for product approvals of the new Trauma Shoulder System and the new knee concept in China and Japan.

Outlook and prospects

Produkte und Märkte

The prime target of *aap*'s sales and marketing strategy in 2003 is to market successfully in Germany and abroad all the product systems that have been developed over the past three years. The focus of our activities will be on boosting our business in bone cement and on launching our new ÆQUOS® knee endoprosthesis in the market or generating significant sales of orthobiological products. Priority will be given to our main sales region, Germany. In addition, enlisting further sales partners in the European region will constitute an important strategic element.

In our international sales strategy we see ourselves confirmed above all in Asian markets and will be concentrating mainly on the threshold country China that already forms a significant mainstay of *aap*'s export business.

To step up working the U.S. market we plan to set up a strong and effective distributor network.

In the business year ahead, research and development work will concentrate on securing approval for an orthobiological bone replacement material as an antibiotics carrier, on concluding the development and securing the approval of an innovative bone cement, and on the market launch of a new bone cement mixing system.

There are no signs of an easement of price competition in the market for bone cements and cementing systems. Even though only a fairly low gross yield can be anticipated, our assessment of the market is that Mebio's competitiveness is not under threat in the endoprosthetics unit, due mainly to the satisfactory market penetration by Palacos® R bone cement and the new EASYMIX® system.

The target for fiscal 2003 is double-digit, profitable sales growth not counting acquisition-related writedowns.

Risks of future corporate developments

Risks form an integral part of every company's business activity and therefore constitute a threat at the same time, but also an essential precondition for enterpreneural success. *aap* has put in place a risk management system with a view to creating scope for action by identifying at an early stage risks that pose a potential threat to its assets, financial and earnings position.

For the further, consistent implementation of restructuring measures already initiated with great success and for the further pursuit of corporate strategy, ensuring corporate finance is a crucial issue. Bearing in mind the highly unfavorable outlook for the capital market, two important success criteria need to be fulfilled. They are achieving sales targets for products that have already been launched successfully, launching successfully the group's new and innovative products (VersaBond™, Cerabone®, Ostim®, ÆQUOS®), and bringing to a successful conclusion talks now underway on proposed capital procurement measures (private placement or borrowing outside capital).

In view of the extraordinarily unfavorable outlook for raising capital on the stock market or finding investors for a private placement, the management has classified negotiations with *aap*'s bankers as the most promising move and has held intensive talks with them since the fourth quarter of 2002. The outcome of these talks is, alongside a liquidity-conserving adjustment of repayment terms and conditions for existing liabilities, a readiness on the banks' part to make fresh funding available. That being so, and as a result of the successful negotiations on implementing a part of the proposed private placement at the second quarter of 2003, liquidity can be ensured for fiscal 2003 to fulfill the present sales and earnings plans.

Should it prove impossible to implement the proposed financing measures successfully, however, *aap* has plans further structural adjustment that will mainly involve a radical downsizing and, logically, sales of assets.

aap's medium- and long-term growth strategy calls in general for signficant investment. As regards finance to implement this stratgegy, *aap* is currently holding talks with potential strategic partners on possible market and product cooperation and on equity procurement measures.

If, alongside realization of the aforementioned criteria, banks and lenders maintain their commitment to short- and long-term loans and talks with potential strategic investors can be brought to a succssful conclusion, the management is working on the assumption that the provision of short- and medium-term corporate financing and implementation of the existing growth strategy can be ensured.

aap as a life science enterprise can only market its products if they have been granted national and/or international approval, so amendments to national statutory approval provisions and possible delays in approval procedures constitute risks for the company.

Global concentration processes, cyclical stagnation and changes in the healthcare sector can also exert a considerable influence on the company's economic development.

By virtue of its international sales strategy, *aap* is also subject to exchange-rate risks. We seek to countervail this risk and the risk posed by international payment flows in general by billing almost entirely in euros, by setting credit limits and by using other hedging tools for receivables, such as bank guarantees and prepayment.

Orthobiology is for *aap* a unit under development that entails risks accordingly. To develop this research-intensive new field of business, both human capital and financial resources are needed to a large degree. The risk on the one hand is that not all product development current and planned in this business field may lead to marketable products. On the other, the succes of the new orthobiology unit will depend crucially on whether *aap* succeeds in converting research results into marketable products and in establishing approved products before competitors do so and marketing them more swiftly than they do.

As for *aap*'s current market positioning and future growth prospects, our capital market valuation is, in our view, well below the actual internal enterprise value. The current market capitalization entails a corresponding takeover risk.

The basis for further positive corporate development is, especially, the market in which we do business. The healthcare market is the growth market of the 21st century. With our sound fundamental data, accompanied by a business strategy with a global focus, a targeted marketing

strategy for our new products and a full product pipeline, we see ourselves as being well prepared, especially after the restructuring measures successfully implemented in the review period.

Berlin, March 28, 2003

The Management Board

Dipl.-Ing. Uwe Ahrens

Dipl.-Ing. Bruke Seyoum Alemu

Consolidated Annual Financial Statement

aap Implantate AG

Consolidated Balance Sheet according to IAS

Assets

	Appendix	1.1.–31.12.2002 €	1.1.–31.12.2002 €	1.1.–31.12.2002 € '000
A. Fixed assets	(1)			
I. Intangible assets				
1. Industrial property rights and similar rights and values as well as licenses		13,708,736.57		13,816
2. Goodwill		3,362,410.99		3,626
3. Activated own contributions		2,955,863.89		2,010
4. Deposits		0		99
			20,027,011.45	19,551
II. Tangible assets				
1. Lands and buildings		1,354,425		1,452
2. Technical plants and machinery		2,073,700.26		2,161
3. Other plant, office systems and outfitting		1,080,454.89		1,253
4. Deposits and plants in construction		0		29
			4,508,580.15	4,895
III. Financial assets				
1. Equity investments	(20)	381,678.48		515
2. Other lendings		290,158.13		288
3. Securities		0		0
			671,836.61	803
B. Current assets				
I. Inventories				
1. Raw materials and supplies		1,039,207.41		1,762
2. Work in process		1,020,585.51		989
3. Finished produvts and merchandise		6,153,810.35		6,450
			8,213,603.27	9,201
II. Accounts receivable and other asssets				
1. Trade receivables	(2)	1,966,318.49		4,802
2. Liabilities towards associated companies		356,965.67		196
3. Other assets		3,554,907.55		2,586
			5,878,191.71	7,584
III. Cash on hand, balance with banks			691,302.15	1,244
C. Prepaid and deferred income	(3)		191,679.07	421
D. Active tax assets	(4)		1,416,099.3	2,611
			41,598,303.71	46,310

EQUITY AND LIABILITIES

	Appendix	1.1.–31.12.2002 €	1.1.–31.12.2002 €	1.1.–31.12.2002 € '000
A. Shareholders' equity	(5)			
I. Subsribed capital		4,764,265		4,764
II. Capital reserve		24,543,367.21		23,964
III. Earnings reserves				
1. Statuatory reserves		41,703.95		42
2. Other earnings reserves		272,207.59		272
IV. Net retained profits/net accumulated losses		-7,639,245.28		-3,210
			21,982,298.47	25,832
B. Minority interests			-268,984.3	-179
C. Special reserves with an equity portion			492,097	526
D. Accruals				
1. Tax accrulas		18,882.21		0
2. Other accruals	(6)	1,006,207.21		672
			1,025,089.42	672
E. Liabilities				
1. Liabilities to banks		10,840,567.97		10,745
2. Payments received to banks		177,335.51		914
3. Trade account payable		1,860,385.81		2,256
4. Liabilities toward assoviated companies		9,914.72		10
5. Other liabilities		5,479,599.11		5,534
			18,367,803.12	19,459
F. Prepaid and deferred income			0	0
			41,598,303.71	46,310

Liabilities to responsibility affairs (21) *€ 1,039,882.81* *(previous year: € 709,000)*

aap Implantate AG
Consolidated Statement of Income
according to IAS

		Appendix	1.1.-31.12.2002		1.1.-31.12.2001
			€	€	€ '000
1.	Revenues	(8)		13,329,130.08	11,976
2.	Changes in invetories of finished goods and work in progress			-72,886.9	-1,712
3.	Production for own fixed assets capitalized			1,514,241.42	1,892
4.	Other operating income	(9)		682,946.27	939
5.	Costs of material				
	a) Expenditures on raw materials and supplies and bought in services		-4,212,547.01		-3,854
	b) Expenditures on bought in services		-321,125.23		-324
				-4,533,672.24	-4,178
6.	Personnel expenses	(10)			
	a) Wages and salaries		-4,187,419.76		-5,104
	b) Social security contributions, pensions and welfare expenses		-652,877.29		-768
				-4,840,297.05	-5,872
7.	Depreciations	(11)			
	a) on tangible assets of fixed assets		-2,880,594.3		-2,690
	b) on current assets		0		-23
				-2,880,594.3	-2,713
8.	Other operating expenses	(12), (15), (16)		-5,142,387.01	-4,970
9.	result of participation	(13)		-133,652.44	-69
10.	Income from long term loans	(14)		22,864.75	21
11.	Interest income	(14)		26,116.1	21
12.	Amortization of financial assets			0	0
13.	Interest expenses	(14)		-1,303,686.6	-958
13.	*Profit/loss on ordinary activities*			*-3,331,877.92*	*-5,623*
14.	Extraordinary income			0	0
15.	Extraordinary expenses			0	0
16.	*Extraordinary result*			*0*	*0*
17.	Income tax	(17)		-1,187,877.25	2,231
18.	Other taxes			21.42	-1
19.	*Net loss*			*-4,519,733.75*	*-3,393*
20.	Minority interests			90,456.17	21
21.	Loss/profit carried forward			-3,209,967.7	162
22.	Net retained losses			-7,639,245.28	-3,210
		Income per share		€ ./. 0.93	€ ./.0.71

aap Implantate AG
Consolidated Cash Flow Statement

		2002	2001
		€ '000	€ '000
1.	Net profit/loss	-4,520	-3,393
2.	Cash non relevant expenditure stock options	579	804
3.	Depreciation on fixed assets incl. bilancing at equity	3,014	2,759
4.	Decrease/Increase in accurals	353	-510
5.	Loss from disposal of fixed assets	26	35
6.	Increase in inventories, accounts receivable and other assets	2,931	-487
7.	Decrease/Increase in accounts payable and other liabilities	-795	-1,234
8.	Increase in special reserves with an equity portion	-34	207
9.	Total cash provided by/used in operating activities	1,554	-1,819
10.	Investments in fixed assets	-1,810	-2,835
11.	Investments in financial assets	-79	-7
12.	Cash provided by investments in financial assets	77	69
13.	Total cash provided by/used in investing activities	-1,812	-2,773
14.	Proceeds from bank loans	1,492	7,284
15.	Repayments of bank loan	-1,711	-2,377
16.	Total cash provided by/used in financing activities	-219	4,907
17.	Cash relevant changes of financial assets	-713	315
18.	Cash and cash equivalents at the beginning of the period	1,244	974
19.	Changes due to currency	-76	-45
20.	Cash and cash equivalents at the end of the period	691	1,244

aap Implantate AG

Statement of Fexed-Asset Movements

according to IAS

	Historical Aquisition costs					cumulative depreciation					Book values	
	Position 01.01.2002	Additions	Transfers	Disposals	Position 31.12.2002	Position 01.01.2002	Depreciations in current year	Disposals	Position 31.12.2002	Appreciations in current year	Position 31.12.2002	Position 31.12.2001
	€	€	€	€	€	€	€	€	€	€	€	€
A. Fixed assets												
I. Intangible assets												
1. Industrial property rights and similar rights and values	15,863,042.32	1,198,357.7	127,822.97	69.63	17,189,153.36	2,047,175.67	1,433,324.4	69.63	3,480,430.44	13.65	13,708,736.57	13,815,866.65
2. Goodwill	4,018,037.22	0	0	0	4,018,037.22	391,912.88	263,713.84	0	655,626.72	0.49	3,362,410.99	3,626,124.34
3. Activated R & D costs	2,054,419.17	1,090,323.81	0	0	3,144,742.98	44,658.54	144,220.55	0	188,879.09	0	2,955,863.89	2,009,760.63
4. Deposits	99,173	28,649.97	-127,822.97	0	0	0	0	0	0	0	0	99,173
	22,034,671.71	2,317,331.48	0	69.63	24,351,933.56	2,483,747.09	1,841,258.79	69.63	4,324,936.25	14.14	20,027,011.45	19,550,924.62
II. Tangible assets												
1. Land and buildings	1,745,034.99	0	0	0	1,745,034.99	293,343.89	97,266.55	0	390,610.44	0.45	1,354,425	1,451,691.1
2. Technical plant and machinery	5,131,290.84	323,580.17	28,583.33	15,079.69	5,468,374.65	2,970,327.29	424,366.36	0	3,394,693.65	19.26	2,073,700.26	2,160,963.55
3. Other plant, office systems and outfittings	3,490,045.62	355,440.85	0	103,230.62	3,742,255.85	2,237,004.76	517,697.78	92,777.25	2,661,925.29	124.33	1,080,454.89	1,253,040.86
4. Deposits	28,583.33	0	-28,583.33	0	0	0	0	0	0	0	0	28,583.33
	10,394,954.78	679,021.02	0	118,310.31	10,955,665.49	5,500,675.94	1,039,330.69	92,777.25	6,447,229.38	144.04	4,508,580.15	4,894,278.84
III. Financial assets												
1. Shares in affiliated companies	679,299.68	0	0	0	679,299.68	163,968.34	133,652.86	0	297,621.2	0	381,678.48	515,331.34
2. Lendings	288,317.49	1,840.64	0	0	290,158.13	0	0	0	0	0	290,158.13	288,317.49
3. Securities	0	76,812.74	0	76,812.74	0	0	0	0	0	0	0	0
	967,617.17	78,653.38	0	76,812.74	969,457.81	163,968.34	133,652.86	0	297,621.2	0	671,836.61	803,648.83
Total	33,397,243.66	3,075,005.88	0	195,192.68	36,277,056.86	8,148,391.37	3,014,242.34	92,846.88	11,069,786.83	158.18	25,207,428.21	25,248,852.29

Statement of Equity and share sof other shareholders from 01.01.2001 to 31.12.2002
according to IAS

	Subsribed capital	Capital reserve	Earning reserves Legal reserves	Other earning reserves	Retained earnings/losses	Group shares	Shares of other shareholders	Total
	€	€	€	€	€	€	€	€
Status 01.01.2001	3,800,000	9,370,989.44	41,703.95	272,207.59	162,198.13	13,647,099.11	-157,834.68	13,489,264.43
Capital increase	964,265	13,788,982.08				14,753,247.08		14,753,247.08
Addition according § 272 clause 2 No 2 HGB		803,991.69				803,991.69		803,991.69
Net loss					-3,372,165.83	-3,372,165.83	-20,693.45	-3,392,859.28
Status 31.12.2001/01.01.2002	4,764,265	23,963,963.21	41,703.95	272,207.59	-3,209,967.7	25,832,172.05	-178,528.13	25,653,643.92
Addition according § 272 clause 2 No 2 HGB		579,404				579,404		579,404
Net loss					-4,429,277.58	-4,429,277.58	-90,456.17	-4,519,733.75
Status 31.12.2002	4,764,265	24,543,367.21	41,703.95	272,207.59	-7,639,245.28	21,982,298.47	-268,984.3	21,713,314.17

Conditional capital: 476,000.00 €

Notes to the Consolidated Financial Statements to December 2002 in accordance with IAS

A. Company Data

Company, domicile

aap Implantate AG, Berlin

Registered office

12099 Berlin, Lorenzweg 5, Germany

Register of companies

The Company is registered at the Berlin-Charlottenburg district court as HRB 64083 and was entered into the court's register of companies on September 10, 1997.

Stock market listing

aap Implantate AG has been traded since May 10, 1999 on the Frankfurt Stock Exchange's Neuer Markt segment under Security ID Number 506 660.

Incorporation by modifying conversion

The Company was incorporated by means of a modifying conversion of *aap* Ahrens, Ahrens & Partner GmbH & Co. Betriebs KG on January 1, 1997.

Type of business

aap Implantate AG is a life science enterprise. Its fields of business comprise osteosynthesis, endoprosthetics, orthobiology and the provision of research and development services in these fields.

B. General Information

1. Basic principles

The consolidated financial statements of *aap* Implantate AG, Berlin, to December 31, 2002 were drawn up in accordance with the International Accounting Standards (IAS) 2002 of the International Accounting Standards Committee (IASC). The interpretations of the Standing Interpretations Committee (SIC) were also followed.

The consolidated financial statements comply with European Union Directive 83/349. Pursuant to § 292 of the German Commercial Code (Handelsgesetzbuch/HGB), which was inserted within the framework of legislation making it easier to raise capital, these financial statements prepared in accordance with IAS have a discharging effect.

The consolidated financial statements of *aap* Implantate AG to December 31, 2002 are based on the financial statements of the companies in the group. These were drawn up applying uniform accounting and valuation methods as used by the parent company in

accordance with the German Commercial Code and the German Stock Corporation Act. The transfer to IAS rules took place at individual company level.

The consolidated balance sheet and the consolidated profit and loss statement are structured in accordance with IAS regulations.

The consolidated profit and loss statement was drawn up using the total costs method.

All figures are in euros (€), the national currency of the parent company.

2. Cash flow statement

The consolidated cash flow statement was drawn up by the indirect method, in compliance with IAS 7.

3. Segment reporting

The business activities of the aap Implantate Group in fiscal 2002 did not extend to heterogeneous fields of business nor to geographical segments with differing opportunity-risk structures. Therefore we have not reported by segment in accordance with IAS 14.

Nonetheless, the information in the notes includes a breakdown of sales revenues by region and business segment.

C. Consolidation Principles

1. Consolidated entity

aap Implantate AG, Berlin — Parent company

	2002 Holding	2001 Holding
CORIPHARM Medizinprodukte GmbH & Co. KG, Dieburg	100%	100%
CORIPHARM Medizinprodukte-Verwaltungs GmbH, Dieburg	100%	100%
CORIMED Kundenorientierte Medizinprodukte GmbH, Dieburg	100%	100%
MEBIO Medizinische Biomaterial Vertriebs GmbH, Dieburg	100%	100%
aap Implants Inc., Plymouth, USA	90%	90%

2. Reporting date of the consolidated financial statements

The fiscal year of the companies included is the calendar year. Accordingly, the consolidated financial statements were prepared to December 31, 2002.

3. Currency translation

The financial statements of the consolidated foreign subsidiary were translated into € in accordance with the functional currency concept.
Since the subsidiary is financially, economically and organizationally an integrated sub-unit of *aap* Implantate AG, the functional currency is the national currency of the parent company.
Accordingly, monetary items were translated at the market exchange rate on the reporting date, and non-monetary items at historic rates.
For reasons of economic efficiency, inventory items were translated at the market exchange rate on the reporting date.
Expenditure and income in connection with non-monetary balance-sheet items was translated at the corresponding historic exchange rate or reporting data exchange rate, and the remaining expenditure and income at average rates.
Differences arising from currency translation were treated as affecting the operating result.

4. Accounting and valuation method

The financial statements of the companies included in the consolidated financial statements were drawn up applying uniform accounting and valuation methods of the parent company.

5. Capital consolidation

Capital consolidation was undertaken by offsetting the participating interests' book values against the subsidiaries' equity capital as revalued pro rata at the time of acquisition (IAS 22).
Where advisable, accrued differences were assigned to assets. The remaining accrued differences were capitalized as goodwill and amortized to affect the operating result over a 15-year period, corresponding to their future economic utility.

6. Debt consolidation

Intra-group receivables and liabilities were offset. Any balancing differences that arose in the reporting period were recorded as affecting the operating result.

7. Consolidation of earnings

In the context of earnings consolidation, internal sales and intra-group income and expenditure were offset. Interim results were eliminated unless they were of minor significance.

D. Accounting and Valuation Methods

Intangible assets are shown at acquisition cost less planned depreciation. Goodwill arising from the individual financial statements is capitalized and, like the goodwill from capital consolidation, amortized in the straight line over a 15-year period.

Development costs are capitalized as intangible assets if a newly developed product or process can be clearly allocated, this is technically feasible, and the company plans to

market it. Further prerequisites for capitalization are the likelihood of deriving future economic utility and a reliable valuation of the asset (IAS 38, 45).

Capitalized development costs are written off according to plan in a straight line over their useful life, as a rule between 5 and 10 years from the date they were put to use (IAS 38, 79). Research costs are recorded as expenses in the period when they are incurred.

Fixed assets are valued at cost of acquisition or production and, where depreciable, after taking into account planned depreciation. The production costs of tangible assets are full costs as per IAS 16.
Interest on loan capital is not capitalized as part of acquisition or production costs (IAS 23).

Movable fixed assets up to a value of € 410.00 are written off in full in the year of accession.

Tangible assets rented by way of financial leasing are capitalized at current market value or at the lower cash value of the leasing installments and written off in a straight line over their foreseeable economic life.

Financial assets are shown in the balance sheet at acquisition cost or at net book value. The shares of associated companies balanced by the equity accounting method are recorded in the balance sheet at pro rata equity plus goodwill (IAS 28).
Loans listed that are subject to interest at the usual market rate are reported in the balance sheet at their nominal value.

Inventories are valued at cost of acquisition or production or at net sale value.
Production costs comprise full costs (IAS 2) and are calculated on the basis of standard activity.
In detail, production costs include in addition to directly chargeable costs appropriate proportions of essential production overheads. These include material and production overheads and production-related administrative costs, as well as straight-line depreciation of production plant and equipment.
Loan capital costs are not capitalized as part of acquisition or production costs. Inventory risks arising from diminished usability are taken account of by means of appropriate reductions in value.
Lower values on the reporting date due to lower net losses on disposal are listed accordingly.

Prepayments received from customers are carried as liabilities.

Long-term production orders are recorded in the balance sheet using the percentage of completion method. The sum to be capitalized according to IAS 11 is shown under accounts receivable and under sales revenue.
The stage of performance is determined according to expenses incurred and project phases that have been demonstrably completed.

Accounts receivable and other assets are shown in the balance sheet at cost of acquisition less essential value adjustments in line with the actual risk of default. Interest-free receivables with a term of more than one year are shown at cash value.

Receivables are translated into foreign currency at the prevailing exchange rate at the time when they were first credited unless there was a lower exchange rate on the reporting date.

Investment allowances are carried as liabilities under the heading special investment allowance items. They are written off, with the resulting effect on earnings, in a straight line in accordance with the useful economic life of the assets thereby acquired.

Stock options granted to employees and management are reported in accordance with the position paper of the German Standardization Council (DSR) both as personnel expenses and as a transfer to capital reserves as per § 272 Sub-section 2 No. 2 HGB.
Transfer to capital reserves is undertaken over a performance period corresponding to the contractually agreed lock-up period of two years. Stock options issued were valued at the time of issue on the basis of the Black/Scholes option pricing model.

Provisions are created if a liability to a third party arising from an event in the past exists, if a claim is likely and if the foreseeable level of the provision required can be estimated reliably. The provisions are set at the settlement amount with the highest likelihood of being agreed.

Tax accruals are shown as arising from temporary differences in the IAS and tax balance sheets and from consolidation transactions.
Deferred tax credits include tax reduction claims arising from the anticipated benefit in subsequent years of existing tax losses carried forward where there is a sufficient degree of certainty that they can be realized. Tax accruals are calculated on the basis of tax rates applicable or expected at the time of realization.

Prepayments received from customers are carried as liabilities.

Liabilities are shown at the repayment figure. Liabilities arising from financing leases are carried as liabilities at the cash value of the leasing installments.
Liabilities are translated into foreign currency at the repayment exchange rate when the liability was incurred or at the higher selling rate on the reporting date.

Income and expenditure that arise after the balance sheet date are shown as accruas and deferrals, as are costs of equity capital procurment.

Contingent liabilities are possible or existing liabilities based on past events that are not likely to involve an outflow of funds. They are not recorded in the balance sheet. The volume of commitment stated in respect of contingent liabilities is in line with the scope of liability existing on the balance sheet date.

Sales revenues are realized when the due delivery or performance has been rendered and the risk has been transferred to the customer. This arrangement does not apply to order-related income resulting from application of the percentage of completion method. Customer discounts and rebates and returned goods are taken into account in the appropriate period corresponding to the sales revenues on which they are based.

In the case of some items, drawing up the consolidated financial statements necessitates estimates and assumptions that affect assets, debts and contingent

liabilities as well as the income and expenditure shown as regards their valuation and level. Actual amounts may diverge from these **estimated values**.

E. Special Notes as per § 292 a HGB

The accounting, valuation and consolidation methods applied in accordance with IAS differ essentially from German commercial law regulations in the following accounting matters.

Intangible assets

IAS requires even self-made intangible fixed assets to be capitalized if the prerequisites for capitalization are fulfilled. HGB forbids capitalization.

Production costs

According to IAS, production costs include production-related costs. Under HGB, the total costs approach includes general administrative costs.

Long-term production orders

HGB stipulates that in the event of long-term orders in principle profit can only be realized after delivery and acceptance of the complete order. IAS requires profit to be realized pro rata to percentage of completion.

Tax Accruals

HGB requires all tax accruals on temporary differences between trading balance sheet and tax balance sheet to be ascertained according to the timing concept. According to IAS, tax accruals should be ascertained on all temporary differences between the amounts stated in the tax balance sheet and in the consolidated balance sheet. Unlike under HGB, tax accruals must also be shown on losses carried forward.

Cost of procuring equity

IAS states that the external costs of procuring equity, less the associated earnings benefits, should be shown in the balance sheet as a deduction from equity that does not affect the operating result. HGB requires transaction costs of this kind to be recorded as affecting expenses.

F. Notes on the Balance Sheet

(1) Fixed assets

For movements in fixed assets, please see the consolidated schedule of assets attached as Annex A1. Accessions totaling € 1,514,000 in the fiscal year were allocated as self-made assets.

1. Intangible assets

Intangible assets acquired against payment are depreciated in a straight line pro rata to the historic acquisition costs.

Useful economic life is as follows:

	Years
Commercial property rights and similar rights and values	3 - 20
Goodwill	15

Book values of intangible assets given as security for liabilities amount to € 11,401,000.

2. Development costs

In the reporting period, development costs totaling € 1.090 million were capitalized. They include directly attributable loan capital costs of € 254,000 ascertained on the basis of the group's average financing cost rate of 11.4%. Development costs relate essentially to the following projects:

Biorigid Femur System
Isoreal prosthesis
Mixing system for bone cement
HF cement
CS balls – absorbent bone replacement

In addition, research and further development costs totaling € 242,000 (previous year € 288,000) were recorded as expenses.
Depreciation in the reporting period totaled € 144,000.

3. Tangible assets

Tangible assets are depreciated in a straight line from historic acquisition or production cost.

Useful economic life is, on average, as follows:

	Years
Land and buildings	50
Technical plant and machinery	5 - 10
Other plant, office and business equipment	5 - 10

No unscheduled depreciation or value reinstatements were undertaken.

The book value of leased tangible assets on December 31, 2002 was € 1,100,000. The book values of tangible assets transferred by way of security or encumbered with land charges totaled € 1,748,000.

4. Financial assets

Beteiligungen	2002		2001	
	€'000	%	€'000	%
1. OSARTIS GmbH & Co. KG, Obernburg	320	49.0	369	49.0
2. GEOT Gesellschaft für Elektro-Osteo-Therapie mbH, Munich	62	30.0	146	30,0
3. Cybernetic Vision AG Health Monitoring Technologies, Berlin	0	5.69	0	5.69
Other lendings	290		288	
Total	672		803	

(2) Accounts receivable and other assets

	31.12.2002 € '000	Remaining term > 1 Jahr € '000	31.12.2001 € '000	Remaining term > 1 Jahr € '000
Trade receivables				
- Percentage of completion	0	0	2.804	0
- Other	1.966	0	1.998	0
	1.966	0	4.802	0
Receivables from companies with which a participation relationship exists	357	357	196	196
Other asset items				
- Tac refund entitlements	15	0	60	0
- Warranty claims	2.299	578	2.385	2.385
- Other	1.241	737	141	0
	3.555	1.315	2.586	2.385
	5.878	1.672	7.584	2.581

The development order accounted for by the percentage of completion method was dealt with during the fiscal year.

The claim for breach of warranty is against the contributing partners of holdings acquired in CORIMED Kundenorientierte Medizinprodukte GmbH, CORIPHARM Medizinprodukte-Verwaltungs-GmbH and CORIPHARM Medizinprodukte GmbH & Co. KG.

(3) Accruals

This item includes € 4,000 in discounts (previous year € 7,000). Further entries include external, directly chargeable transactions costs totaling € 120,000 for equity transactions planned for fiscal 2003. On implementation of a capital increase, these

costs will be reduced by the associated earnings tax benefits in the form of a deduction from equity capital.

(4) Deferred taxation

Tax accruals carried as assets totaling € 1,416,000 (previous year: € 2,611,000) include the following tax credit entitlements arising from the anticipated utilization of existing loss carryovers in the years ahead:

	2002 €'000	2001 €'000
Corporate income tax, including solidarity surcharge (or comparable tax on earnings in other countries)	1,516	2,293
Trade tax	1,114	1,582
	2,630	3,875

Realization of these loss carryovers is guaranteed with a sufficient degree of certainty.

Deferred tax credit claims totaling € 507,000 resulting from loss carryovers at aap Implants Inc. were written back in the year under review.

Deferred tax liabilities totaling € 1,206 million are due to consolidation (elimination of interim results and debt consolidation including currency differences) and from temporary differences between tax values and amounts stated for balance sheet items drawn up according to IAS.

Trade earnings tax was assessed on the basis of the annual result according to IAS by adding trade tax paid and subtracting trade earnings. Trade tax is charged at roughly 17% taking into account its tax deductibility. Corporate income tax payable was determined on the basis of a tax rate of 25% plus a 5.5% solidarity surcharge on corporate income tax due.

Deferred tax credits relating to consolidation were ascertained on the basis of a group average tax rate of 39%.

(5) Equity

On December 31, 2002 the company's capital stock totaled € 4,764,265, consisting of 4.764.265 individual bearer shares.

The statutory reserve totaled € 41,703.95 at the end of the fiscal year and, together with the capital reserve, exceeded one tenth of capital stock.

Conditional capital

The General Meeting held on June 30, 2000 approved a conditional increase of up to € 380,000.00 in capital stock by the issue of up to 380,000 individual bearer shares.

The General Meeting held on May 29, 2001 approved a further conditional capital increase of € 96,000.00 by the issue of 96,000 individual bearer shares. New shares are entitled to profit from the start of the fiscal year in when they are issued.
The conditional capital is solely for the purpose of granting stock options to employees and management of the company or of an associated company, as follows:

2000
- 42.1% to board members and senior executives of the company and of associated companies,
- 57.9% to employees of the company and of associated companies.

2001
- 17.1% to board members of the company and of associated companies
- 25% to senior executives
- 57.9% to employees of the company and of associated companies

Stock options will be granted in accordance with the provisions of the 2000 and 2001 stock option plans respectively.

Under the 2000 stock option plan, 256,727 stock options were agreed.

The options entitle the holder to subscription rights only after a two-year lock-up period and when the average final trading price of shares in the company on the Frankfurt Stock Exchange during the 20 trading days prior to issue of the subscription right has increased by at least 20% on the price of issue and this price increase is higher than the percentage gain of the Frankfurt Stock Exchange CDAX Pharma & Healthcare Performance Index during the same period.

The issue price will correspond to the average final trading price on the Frankfurt Stock Exchange over the 20 trading days prior to exercise of the option, but in any case at least the lowest issue price as defined in § 9 sub-section 1 of the German Stock Corporation Act (AktG).

Stock options

	Number originally issued	Status as at Dec. 31, 2001	No. lapsed in 2002	Status at Dec. 31, 2002
Tranche 2000	256,727	206,543	27,795	178,748

Stock subscription price: roughly € 15
The stock options run for a period of four years from the date of issue (Dec. 1, 2000).

The right to exercise a stock option is limited to four three-week periods a year, each starting on the day after publication of the quarterly results or the annual financial statements.

In fiscal 2002, a partial sum of € 579,000 was charged as expenses and allocated to capital reserves.

Approved capital

The Management Board is authorized, subject to approval by the Supervisory Board, to increase the company's equity by March 31, 2005 on one or more occasions by up to € 2,380,000.00 against deposits in cash or kind and to specify the terms and conditions on which shares are issued.

This may include ruling out subscription rights for existing shareholders

a) to offset residual amounts,
b) to issue shares to employees of the company,
c) to acquire participating interests in enterprises or from enterprises or parts of enterprises in return for company stock,
d) if a capital increase in cash does not exceed 10% of the equity capital and the issue price for the shares is not substantially lower than their stock market price,
e) to meet the costs of raising capital and paying for services.

Please see the schedule of equity in Annex 3.2.

(6) Other provisions

	Status as at 01.01.2002	Take-up	Re-transfer	Transfer	Status as at 31.12.2002
	€'000	€'000	€'000	€'000	€'000
Commitments to employees	175	174	1	144	144
Bonuses granted	81	79	2	46	46
Annual financial statements audit costs	104	91	9	148	152
Unpaid invoices	219	162	27	293	323
Share listing	0	0	0	300	300
Costs and risks of legal action	20	20	0	18	18
Payments to dormant partners	8	8	0	0	0
Commitments to former employees	44	37	7	0	0
Warranties	21	0	0	2	23
	672	571	46	951	1.006

All provisions shown have a term of up to one year.

(7) Liabilities

Times to maturity of liabilities, broken down by balance-sheet heading, are as follows:

	Time to maturity					
	Dec. 31,2002 total	up to 1 year	1–5 years	more than 5 years	Previous yr. total	Previous year maturity > 1 year
	€'000	€'000	€'000	€'000	€'000	€'000
Amounts owed to banks	10,841	8,565	1,722	554	10,745	6,739
Prepayments received on orders	177	177	0	0	914	0
Trade receivables	1,860	1,860	0	0	2,256	0
Liabilities to associated companies	10	10	0	0	10	0
Other liabilities	5,480	2,107	3,373	0	5,534	3,617
of which						
(Social security-related)	(621)				(105)	(0)
(Arising from taxes)	(194)				(153)	(0)
Leasing commitments	(742)	(422)	(320)		(947)	(604)
	18,368	12,719	5,095	554	19,459	10,356

Of the amounts owed to banks, € 1,176,000 is secured by land charges and by assignments of various machines and accounts receivable, and € 1,599,000 by assignments of a license/patent pool. The contributing shareholders of the MEBIO/CORIPHARM Group gave absolute guaranty for a total of € 856,000.

Of long-term liabilities (time to maturity > 1 year) totaling € 5,649,000, € 5,491,000 (previous year € 10,356,000) was interest-bearing. The average interest charge was approximately 11.4% (previous year approx. 11%).

G. Notes on the Profit and Loss Statement

(8) Sales revenues

	2002 €'000	2001 €'000
By region		
Germany	9,206	9,259
Asia	2,416	1,256
Africa	27	113
The Americas	771	604
Europe	909	744
Total	13,329	11,976
By segment		
Endoprosthetics	5,936	5,688
Osteosynthesis	7,052	5,900
Orthobiology	119	15
R&D services	222	373
Consolidated total as per IAS	13,329	11,976

(9) Other operating income

	2002 €'000	2001 €'000
Private car use	61	67
Income from re-transfer of provisions	46	94
Income from write-back of special item for investment allowances and premiums	164	255
Contract penalties	137	0
Income from expense allowances	0	55
Insurance claims	0	84
Claims for damages	31	58
Schadensersatzansprüche	0	65
Income from reduction in individual value adjustment of receivables	5	16
Other	239	245
	683	939

(10) Personnel costs

	2002 €'000	2001 €'000
Wages and salaries	4,187	5,105
(of which stock options issued)	(579)	(803)
Social contributions and expenses for old-age provision and for support	653	768
	4.840	5.873

Average payroll during the year

	2002	2001
Wage earners	50	49
Salary earners	59	71
	109	120

(11) Depreciation

Depreciation on tangible assets totaled € 1,039,000 (previous year: € 1,046,000) and on intangible assets € 1,841,000 (previous year: € 1,643,000), of which € 264,000 was amortization of goodwill resulting from the capital consolidation (previous year: € 242,000).

(12) Other operating expenses

	2002	2001
	T€	T€
Advertising and travel costs	661	911
Cost of premises	721	707
Consulting fees	537	757
Leasing	123	151
Office requisites, telephone, fax, postage	181	237
Sales commission	0	112
Outgoing freight charges, packaging material, cost of delivery	476	251
Vehicle costs	154	192
Repairs and maintenance	99	181
Insurances, subscriptions, fiscal/public charges	185	174
Losses and value reductions arising from accounts receivable	261	114
Third-party services	0	160
Patent fees, other fees	196	166
Share listing costs	300	0
Development costs	173	189
Currency differences	82	57
Other costs	609	254
	5.142	4.970

(13) Result of participating interests

This includes the pro rata result of participating interests accounted for by the equity method in OSARTIS GmbH & Co. KG and GEOT Gesellschaft für Elektro-Osteo-Therapie mbH, totaling –€ 90,000 (previous year –€ 29,000), and amortization of € 44,000 (previous year € 40,000) on the goodwill acquired.

(14) Financial result

	2002 €'000	2001 €'000
Income from other lendings	23	21
Other interest and similar income	26	22
Other interest and similar expenditure		
Interest on long-term debts to banks	./. 672	./. 458
Interest on current debts to banks	./. 316	./. 220
Interest of sleeping partners	./. 180	./. 176
Write-back of financing costs	./. 52	./. 72
Other interest expenditure	./. 84	./. 33
	./. 1.304	./. 959
	./. 1.255	./. 916

(15) Exchange-rate differences

Exchange rate differences affecting the operating result in the accounting period were:

	2002 €'000	2001 €'000
Income from exchange rate differences	5	4
Cost of exchange rate differences	./. 82	./. 57
	./. 77	./. 53

(16) Income and expenditure unrelated to the accounting period

In fiscal 2002 there was no income or expenditure unrelated to the accounting period that was important for assessing the earnings situation.

(17) Taxes on earnings

Theoretical tax expense can be deduced as follows from the tax expenditure according to IAS (cf 6, above). This is based on a tax rate of 39% (previous year: 39%), comprising German corporate income tax plus solidarity surcharge and trade tax.

	2002 €'000	2001 €'000
Pre-tax earnings	./. 3,332	./. 5,623
Deductible other taxes	0	./. 1
Basis for assessment	./. 3,332	./. 5,624

Theoretical tax expense 39% (previous year 39%)	./. 1299	./. 2.193
Difference due to divergent national tax rate	0	./. 13
Tax effects on		
- Amortization of goodwill resulting from capital consolidation and companies balanced by the equity method	120	110
- Write-back of deferred tax credits resulting from adjustment of loss carryovers	2,346	0
- Non-tax-deductible expenses and additions to trade tax	52	189
- Results of associated companies	0	./. 275
- Previous year earnings tax payments	0	19
- Tax-free income	./. 31	./. 58
- Other effects	0	./. 10
Earnings tax outlay according to IAS	1,188	./. 2,231
Effective tax rate in %	36 %	39,7 %

(18) Earnings per share according to IAS 33

Undiluted earnings per share are calculated by dividing the period result for the shares by the average weighted number of shares.

	2002	2001
Result for the period	€ ./.4,429,000	€ ./. 3,372,000
Number of shares ('000s)	4,764,000	4,764,000
Earnings per share	€ ./. 0.93	€ ./. 0.71

Diluted earnings per share take into account the weighted average potential number of shares as a result of the 167,641 stock options issued on December 1, 2000 that were still valid.

	2002	2001
Result for the period	€ ./. 4,429,000	€ ./. 3,372,000
Diluted no. of shares ('000s)	4,943,000	4,971,000
Earnings per share	€ ./. 0.90	€ ./. 0.68

(19) Cash flow statement

The inflow of funds from current business activities includes inter alia:

Interest income € 23,000 (previous year: € 20,000)

Interest expenses € 842,000 (previous year: € 738,000)

Earnings tax paid amounts to € 6,000 (previous year: € 19,000). Earnings tax refunded was € 0 (previous year: € 0).

(20) Participating interests

I. Allied enterprises (§ 271 sub-section 2 HGB)

	Name	Domicile	Participation	Capital stock	Result
			%	€	€
1.	*aap* Implants Inc.	USA, Massachusetts	90	./. 1,901	./. 905
2.	CORIMED Kunden-orientierte Medizin-produkte GmbH	Dieburg	100	./. 107	./. 59
3.	CORIPHARM Medizinprodukte Verwaltungs GmbH	Dieburg	100	31	1
4.	CORIPHARM Medizinprodukte GmbH & Co. KG	Dieburg	100	./. 1,181	./. 442
5.	MEBIO medizinische Biomaterial Vertriebs GmbH	Dieburg	100	./. 32	./. 26

This information relates to financial statements in accordance with IAS.

II. Associated enterprises

	Name	Domicile	Participation	Capital stock	Result
			%	€	€
6.	OSARTIS GmbH & Co. KG	Aschaffenburg	49	./. 654	./. 36

This information relates to financial statements in accordance with IAS.

	Name	Domicile	Participation	Capital stock	Result
			%	€	€
7.	OSARTIS Verwaltungs GmbH	Aschaffenburg	49	--	--
8.	GEOT Gesellschaft für Elektro-Osteo-Therapie mbH	Munich	30	./. 321	./. 242

This information relates to financial statements in accordance with German commercial law.

III. Shareholdings

	Name	Domicile	Participation	Capital stock	Result
			%	€	€
9.	Cybernetic Vision AG Health Monitoring Technologies	Berlin	5.96	--	--

Insolvency proceedings were initiated on December 1, 2000 in respect of the assets of Cybernetic Vision AG.

(21) Contingencies

Under the agreement dated November 11, 2000 for the contribution of capital and the supplementary agreement dated May 4, 2001, *aap* Implantate AG undertook to replace third-party guarantees provided by the partners of the companies brought in for liabilities totaling € 856,000 by other securities by June 30, 2001.

CORIPHARM Medizinprodukte GmbH & Co. KG has given an absolute guarantee limited to a maximum of € 184,000 for the liabilities of OSARTIS GmbH & Co. KG.

(22) Other financial commitments

Other financial commitments as defined by § 285 No. 3 HGB arise from rental agreements totaling € 1,702,000, of which € 575,000 falls due within one year, while the remaining € 1,127,000 is payable within two to five years.

By contractual agreement, the purchase price for the holding in GEOT Gesellschaft für Elektro-Osteo-Therapie mbH will rise from € 184,000 by 15% of the sum by which the enterprise value of the company on December 31, 2002 and December 31, 2004 exceeds the valuation of € 614,000 on which the purchase price was based. The purchase price is limited to a maximum of € 675,000. As a result, there is a pending financial liability of between € 0 and € 491,000.

Minimum lease payments

	Financial leasing Nominal value €'000	Cash value €'000	Operate leasing Nominal value €'000
Payable within 1 year	318	286	104
Payable in 1 to 5 years	289	227	32
Payable after more than 5 years	0	0	0
	607	513	136

Commitments arising from financing leasing relate mainly to installment purchase agreements for production machines and a computer system. The operational leasing agreements relate to short-term contracts for cars and in some cases provide for options to extend or purchase.

(23) Related enterprises and persons

Related enterprises consist of OSARTIS GmbH & Co. KG and GEOT as associated enterprises. During fiscal year 2002 business with them resulted in the following balance-sheet items:

	OSARTIS KG €'000	GEOT €'000
Intangible assets	107	-
Bought-in goods and services	11	-
Cost of waiver of claims outstanding	-	./. 207

aap Implantate AG adjusted outstanding claims totaling € 207,000 from GEOT Gesellschaft für Elektro-Osteo-Therapie mbH as a precaution against risks.

A sales agreement was signed between MEBIO Medizinische Biomaterialien Vertriebs-GmbH and OSARTIS GmbH & Co. KG in the year under review.

Mr. Uwe Ahrens in 2000 loaned the reporting company a total of € 2,556,000 to finance the acquisition of shares in MEBIO-CORIPHARM-Gruppe. Interest is payable at 7% and 7.5%. The interest charge in the fiscal year amounted to € 51,000.

The loans run until May 30, 2006, and € 307,000 has been repaid. The balance on December 31, 2002 was € 754,000. Interest is payable at the 3-month Euribor rate.

(24) Management Board, Supervisory Board

Member of the company's Management Board in the year under review were

Mr. Uwe Ahrens, Dipl.-Ing., Berlin,
Mr. Bruke Seyoum Alemu, Dipl.-Ing., Berlin,

Management remuneration totaled € 304,805.64.

The members of the Board received 78,182 stock options. In fiscal 2002 a partial sum of € 340,000 was transferred to capital reserves and charged as expenses.

The members of the Management Board hold the following Supervisory Board directorships:

Mr. Uwe Ahrens:
STM Medizintechnik GmbH (from 23.04.2002)
bmp AG Venture Capital & Network Management, Berlin
mediport Venture GmbH
HJS Gelenksysteme GmbH
Celon AG

The members of the company's Supervisory Board in the year under review were:

Mr. Lothar Just, accountant and tax adviser, Berlin	(Chairman)
Mr. Klaus Kosakowski, Dipl. Volkswirt, Berlin	(Vice-Chairman)
Mr. Dieter Borrmann, Dipl. Ingenieur, Berlin	
Prof. Dr. Dr. h. c. Horst Cotta, Heidelberg	
Mr. Roger Bendisch, Diplom-Kaufmann, Berlin	(until 14.06.2002)
Dr. Friedrich-Leopold Freiherr von Stechow, businessman, Berlin	(from 14.06.2002)
Dr. Heinz Helge Schauwecker, senior medical consultant and university teacher, Berlin	

The Supervisory Board members were elected for the full term of office under the company's articles of association until the end of the General Meeting that resolves to discharge the Board for fiscal 2002.

Mr. Bendisch announced on January 30, 2002 his intention to retire from the Supervisory Board at the General Meeting that discharged the Board for fiscal 2002.

The General Meeting held on June 14, 2002 resolved to elect Dr. Friedrich-Leopold Freiherr von Stechow to replace Mr. Roger Bendisch on the Supervisory Board, subject to the proviso that his term in office would end at the conclusion of the General Meeting that discharges the Board for fiscal 2002.

Supervisory Board remuneration totaled € 44,098.90 in the year under review.

Members of the Supervisory Board hold the following Supervisory Board directorships in addition to their work on behalf of aap Implantate AG:

Mr. Klaus Kosakowski:	Golf- und Country Club Seddiner See AG - Chairman -
Mr. Roger Bendisch:	OPIX AG, Berlin – Vice-Chairman, aquinto AG, Berlin

Share ownership by members of the Supervisory Board and the Management Board, is as follows:

	Shares		Options	
	2002	2001	2002	2001
Supervisory Board				
Lothar Just	0	0	0	0
Klaus Kosakowski	3,000	3,000	0	0
Prof. Dr. Dr. h. c. Horst Cotta	10,000	10,000	0	0
Dr. Heinz Helge Schauwecker	2,966	2,966	0	0
Dieter Bormann	0	0	0	0
Dr. Friedrich-Leopold Freiherr v. Stechow	0	0	0	0
Management Board				
Uwe Ahrens	1,298,603	1,306,303	44,676	44,676
Bruke Seyoum Alemu	1,000	1,000	33,506	33,506

(25) Statement on the German Corporate Governance Code

aap Implantate AG has issued a declaration of compliance with the German Corporate Governance Code in accordance with § 161 AktG and made it accessible to shareholders.

(26) Publication

The company's Management Board on February 28, 2003 approved these consolidated financial statements to December 31, 2002 for publication.

(27) Events after the balance-sheet date

Subject to board approval, the Group's bankers in March 2003 agreed to suspend redemption payments for fiscal 2003 and to issue new loans totaling € 450,000.

The company's management decided to wind up the company's U.S. subsidiary aap Implants Inc..

Berlin, March 28, 2003

The Management Board

Dipl.-Ing. Uwe Ahrens

Dipl.-Ing. Bruke Seyoum Alemu

Auditor's Certification

We have audited the consolidated financial statement drawn up by *aap* Implantate AG, consisting of the balance sheet, the income statement, the development of equity capital, the statement of fixed assets movements and the notes on the consolidated financial statement for the business year Jan. 1 to Dec. 31, 2002.

Drawing up the accounts and the consolidated financial statement is the responsibility of the company's management board. Our task is to assess, on the basis of our audit, whether the consolidated financial statement complies with International Accounting Standards (IAS).

We carried out our audit of the consolidated financial statement in accordance with German auditing regulations and observing both the principles of proper auditing laid down by the Institute of Auditors in Germany (IDW) and, in addition, the International Standards on Auditing (ISA). These state that the audit is to be planned and executed in such a way as to make it possible to judge with sufficient certainty whether the consolidated financial statement is free of material inaccuracies. In determining the auditing activities, knowledge of the company's business activities and its economic and legal environment and expectations of potential errors are taken into account. As part of our audit, evidence of the values stated and information given in the consolidated financial statement was assessed on the basis of random checks.

The audit includes an evaluation of the accounting principles employed and fundamental assessments undertaken by the company's legal representatives and forming an opinion on the overall picture presented in the consolidated financial statement. We are of the opinion that our audit forms a sufficiently sound basis for our judgment.

We are convinced that the consolidated financial statement conveys, in keeping with IAS, a true and accurate picture of the group's assets, financial and earnings situation and of payments flows during the business year.

Our audit, which also covered the consolidated management report drawn up by the Management Board for the business year Jan. 1 to Dec. 31, 2002, has led to no objections. In our considered opinion, the consolidated management report conveys an accurate picture of the group's situation and accurately describes the risks of future development.

We also confirm that the consolidated financial statement and consolidated management report for the business year Jan. 1 to Dec. 31, 2002 fulfill the preconditions for exemption from the requirement to draw up a consolidated financial statement and consolidated management report in accordance with German statutory requirements. Our check of the consolidated financial statement's compliance with the 7th EC Directive as required for exemption from presenting accounts in accordance with German law was based on the interpretation of the directive made by the European Commission's Contact Committee on the Accounting Directives.

Without limiting this assessment, we draw attention to the statements made in the management report where, under the heading "Risks of future corporate developments," it is noted that if the financing concept as outlined is not implemented and if the current sales and earnings plans are not fulfilled, the continuation of the company's business activity may be under threat.

Berlin, March 28, 2003

Dr. Röver & Partner KG
Auditors
Tax Accountants

Helmut Schuhmann
Auditor

Dr. Reinhard Schubert
Auditor