aap Implantate AG

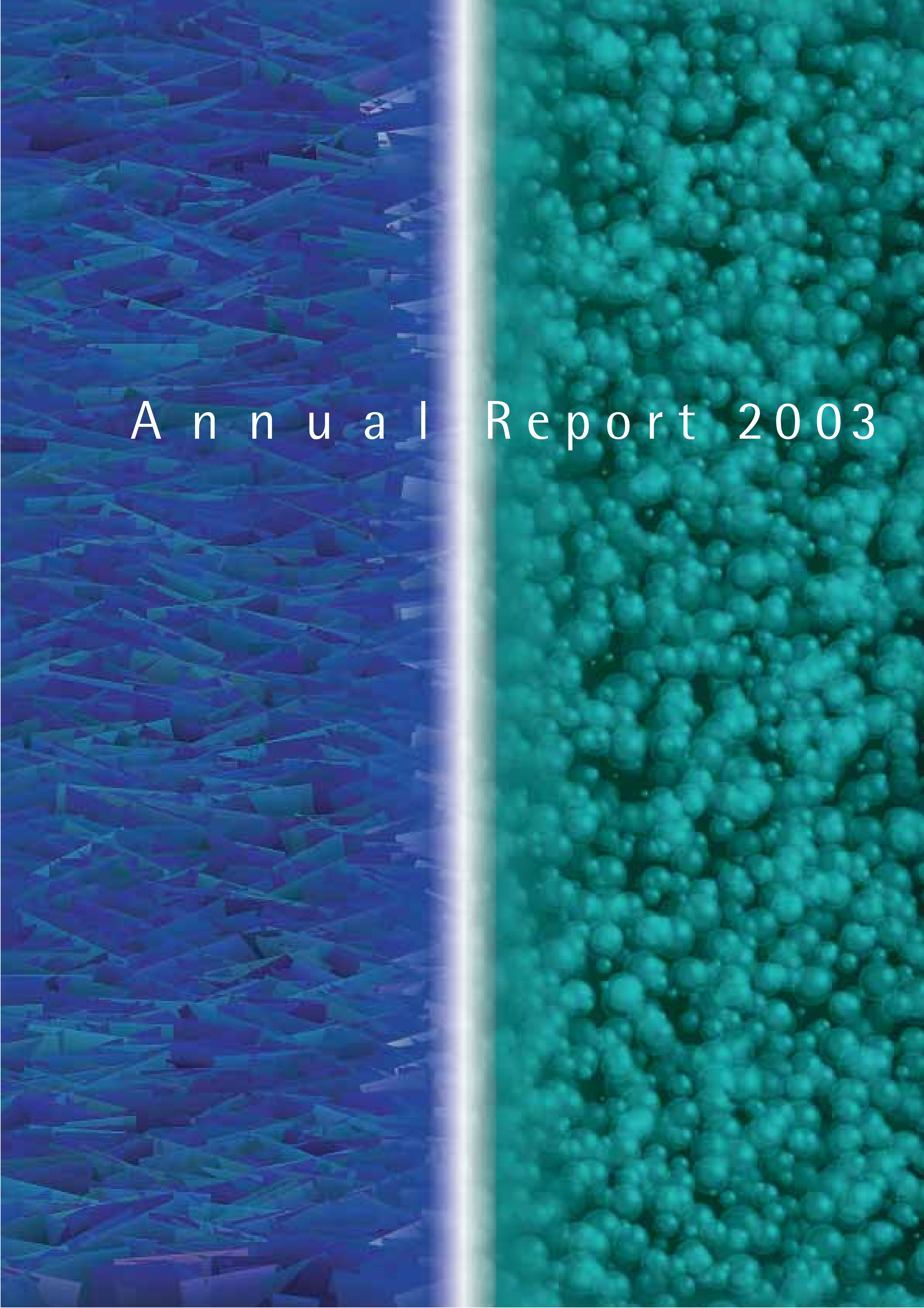
Annual Report 2003

Consolidated Performance Figures

	▶ 1.1.–31.12.2003	▶ 1.1.–31.12.2002
▶ Sales	10,960 T€	13,329 T€
▶ Total output	12,591 T€	14,770 T€
▶ EBITDA without stock options	-273 T€	1,607 T€
▶ Acquisition-related depreciations	1,461 T€	1,461 T€
▶ Stock Options as personnel expenses	0 T€	579 T€
▶ Results without acquisition related depreciations and stock options		
▪ EBIT	-3,175 T€	188 T€
▪ DVFA/SG earnings	-3,170 T€	- 3,066 T€
▪ DVFA/SG earnings per share	-0.66 €	-0.64 €
▪ DVFA/SG Cash Earnings	-1,273 T€	-1,680 T€
▶ Results with acquisition related depreciations and stock options		
▪ EBIT	-4,636 T€	-1,853 T€
▪ DVFA/SG earnings	-4,180 T€	-4,429 T€
▪ DVFA/SG earnings per share	-0.87 €	-0.93 T€
▪ DVFA/SG Cash Earnings	-822 T€	-1,583 T€
▶ Fixed assets	13,031 T€	25,207 T€
▶ Current assets	13,672 T€	16,391 T€
▶ Stockholder´s equity	6,274 T€	21,713 T€
▶ Loan capital	20,429 T€	19,884 T€
▶ Balance sheet total	26,703 T€	41,597 T€
▶ Equity ratio	23 %	53 %
▶ Employees	102	109

T€ corresponds to € 1,000

Annual Report 2003



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Uwe Ahrens Bruke Seyoum Alemu

Foreword by the Board of Management

Ladies and Gentlemen,
Dear Shareholders,
Dear Employees and Business Partners,

▶ In 2003, *aap* went through a very difficult business year, a year characterized by marked sales and earnings declines. The keynote of company policy was to secure corporate financing and the continuation of restructuring measures. After intensive negotiations with our banks and with a group of German and Swiss financial investors, a financing concept to consolidate and recapitalize the company was agreed at the end of May 2004.

In the orthobiologics segment we were able to reach an important milestone in securing European approval of the innovative synthetic bone replacement material PerOssal®. Along with existing products – the nanocrystalline hydroxylapatite matrix Ostim®, the bone cement VERSABOND™ the smart hip prosthesis VarioFit® and stable-angle plates –, *aap* now has at its disposal five growth motors as a basis for the years ahead.

We would like to take this opportunity of thanking our employees most cordially for their loyalty and commitment.

We also have our shareholders and business partners to thank for the confidence they have shown in us, and look forward to further good cooperation.

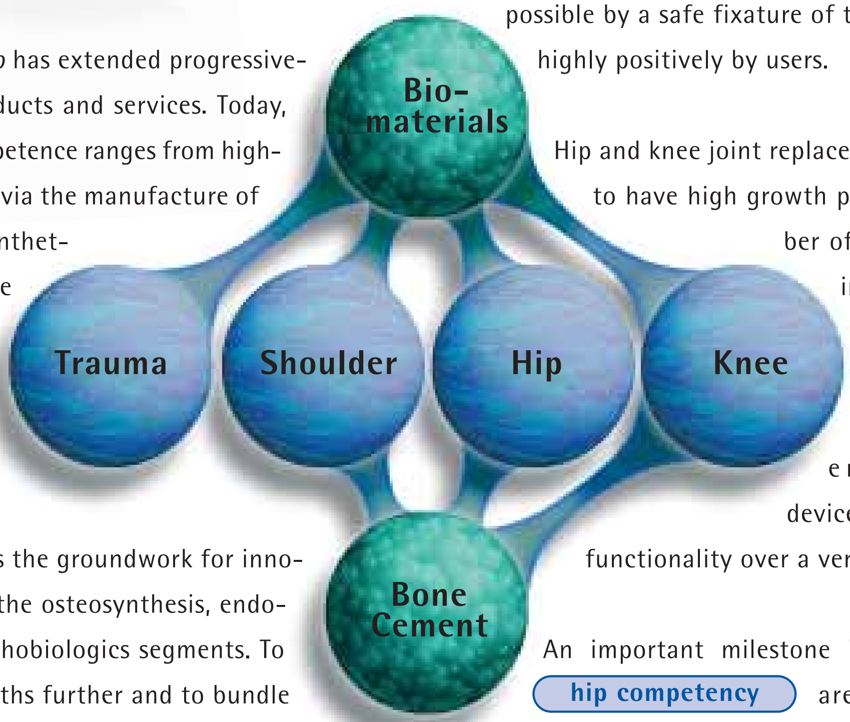
Uwe Ahrens
Chairman of the Board

Bruke Seyoum Alemu
Member of the Board

Product and Technology Competencies

▶ Ever since it was founded, *aap* has concentrated on developing and manufacturing innovative implants for the musculoskeletal system. The focus has always been on the state of the art in both medicine and technology. In close partnership with the medical profession, the best possible patient care is thereby assured.

In recent years, *aap* has extended progressively its range of products and services. Today, its technology competence ranges from high-tech metalworking via the manufacture of bone cements to synthetic procedures for the production of biological bone replacement material.



This know-how lays the groundwork for innovative implants in the osteosynthesis, endoprosthetics and orthobiologics segments. To increase our strengths further and to bundle our resources, we are concentrating in our ongoing strategic alignment on establishing and consolidating the **six competence areas trauma, shoulder, hip, knee, bone cement and biomaterials.**

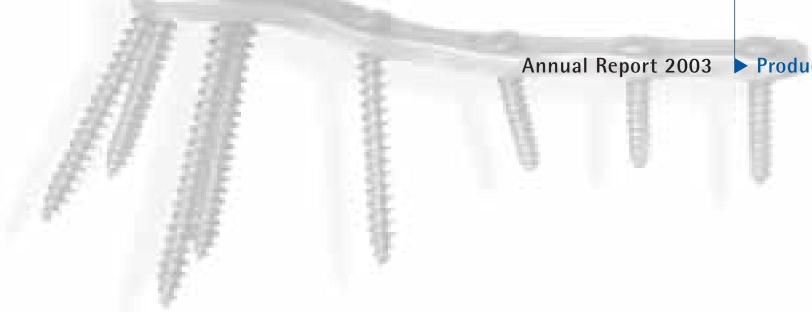
The **trauma competency** has been extended to include stable-angle plates for the upper and lower arm. These plates are pre-shaped anatomically, and stable-angle embedding in the bone is accomplished by means of a spherical thread. The stability that can be achieved even in osteoporotic bone by using these implants permits a swift rehabilitation of the patient.

The most successful implants in the **shoulder competency** segment have for years included, along with the highly innovative trauma shoulder system, the AcroPlate® with constantly growing sales figures in Germany and abroad. The minimally invasive surgery and the early mobility of the patient that is made possible by a safe fixature of the injury are rated highly positively by users.

Hip and knee joint replacement will continue to have high growth potential. The number of implants is growing by the year, and the increase in life expectancy of patients calls for endoprosthetic devices that retain their functionality over a very long period.

An important milestone in developing the **hip competency** area is the market launch of the VarioFit® system. Being modular in design, this endoprosthesis makes it possible to restore virtually any individual hip anatomy to compensate for previous malformations. With VarioFit®, the possible impingement problem of the shaft of the endoprosthesis hitting the hip socket can be counteracted successfully. Even under complicated anatomical conditions the implant can be expected to take normal strain and withstand longer periods in a standing position.

Experience with the technical implementation of natural knee movement in an endoprosthesis formed the basis for developing a monocondylar knee replacement that adds to our offering in the



knee competency area. Using this implant, given locally limited wear and tear on the knee it is possible to replace only this part of the bone prosthetically. Minimally invasive surgery is easy on both the bone and muscles and ligaments. As a result, the patient swiftly regains freedom from pain, and a sufficient bed of bone is retained for further surgery that might prove necessary, especially among younger patients. The monocondylar knee will reach market maturity in the second half of 2004.

The **bone cement competency** complements the joint replacement implants offered. To ensure a safe anchoring of endoprosthetics in the bone, we offer our customers in the German and foreign markets the bone cements Palacos R and VERSABOND™ that guarantee simple and safe handling in the operating theater. An HF cement is under development. The specially devised EASYMIX® system ensures that the cements have outstanding mechanical properties.

Biomaterials support the latest forms of therapy in bone treatment. Bone defects are frequently a side effect of fractures and of wear and tear on joints. Filling up these defects is then of decisive importance for the healing process. The bone replacement materials Ostim® and PerOssal® from the **biomaterials competency** are fully resorbed after implantation. Both contain nanoparticular hydroxylapatite to speed up the creation of new bone substance. Using Ostim®, even small defects can be filled in completely due to its paste-like consistency, while PerOssal® can be used in infected areas at the same time as a local dose of antibiotics.

The introduction of flat-rate payments in clinics and hospitals presents new challenges to medical technology. The indication alone is no longer the foremost consideration in developing implants. The focus is on the entire treatment process with strict attention to the flat-rate payment system and its consequences.

In **bundling products from different competency areas** we offer our customers case-related total solutions from a single source. The biomaterials and cement especially provide outstanding opportunities to round off the trauma, shoulder, knee and hip competency areas as complementary products.

Our aim is to make possible with our products treatment of the patient at the highest medical level while optimizing quality and costs. With a balanced price-performance ratio we seek to enhance both the efficiency and the economy of the healing process.

History

2003

In securing European approval of the innovative bone replacement material PerOssal®, *aap* further extends its competency in orthobiologics.

2002

aap sets a new standard in bone regeneration with its new, nanotechnology-based bone matrix Ostim®

2001

In launching a new bone cement and a new bone replacement material, *aap* positions itself successfully as a specialist in biomaterials

2000

aap expands its biological implants line of business by means of acquisitions

1999

Going Public

1997

Conversion into a stock corporation (Aktiengesellschaft)

1990

Management buyout and foundation of *aap* GmbH & Co. Betriebs KG

1986

Takeover by Johnson & Johnson

1970

Foundation of Mecron med. Prod. GmbH

Equity Story

HIGH GROWTH POTENTIAL

Outstanding starting-point for a leading position in the orthobiologics market

Above-average sales and earnings potential with innovative biomaterials

13 product systems at the start of their product lifecycles

HIGH INNOVATIVE STRENGTH

40 working patents/design patents/ registered trade marks

Over 30% of sales revenues from innovation-leading products

BALANCED TECHNOLOGY MIX

3 technology competencies:
High-tech metalworking
Bone cement
Orthobiologics

BALANCED PRODUCT MIX

6 product competencies:
Trauma
Shoulder
Hip
Knee
Bone cement and cementing technology
Orthobiologics

HIGH QUALITY AND ENVIRONMENTAL STANDARDS

Entire product range is licensed for the European market

7 product group and system approvals for the US market

6 product group and system approvals for the Japanese market

Entire osteosynthesis product range and full hip endoprosthetic range licensed for the Chinese market

SALES WITH AN INTERNATIONAL PRESENCE

Broad customer base with countrywide German sales activities

International sales focus on Asia, Europe and North America

Represented by selected partners in growth and high-margin markets

Group structure chart

aap Implantate AG
Research and development
Production and sales

MEBIO/CORIPHARM-GRUPPE

100%
Mebio
Medizintechnische Biomaterialien Vertriebs-GmbH, Dieburg
Sales company for cemented endoprosthetics, biological bone replacement and local wound healing in Europe

100%
Coripharm Medizinprodukte-Verwaltungs-GmbH, Dieburg
General partner in Coripharm KG

100%
Coripharm
Medizinprodukte GmbH & Co. KG, Dieburg
Research, development and production company for cemented endoprosthetics, biological bone replacement and local wound healing

49%
Osartis Verwaltungs-GmbH, Obernburg
General partner in Osartis KG

49%
Osartis
GmbH & Co. KG, Obernburg
Development, production and patent administration company for bone replacement materials with and without growth factors

30%
geot
Gesellschaft für Elektro-Osteotherapie mbH, München
Research, development and sales company for electro-osteostimulation processes to accelerate healing of bone fractures

90%
***aap* Implants, Inc., Plymouth, USA**
Sales company for osteosynthesis products in the U.S. market ("sleeping company")

Corporate Governance

▶ *aap* Implantate AG issued on December 18, 2003 the following declaration of conformity:

Declaration by the Management Board and Supervisory Board of *aap* Implantate AG on the recommendations of the Government Commission German Corporate Governance Code as per § 161 of the German Stock Corporation Act (AktG)

Since issuing its last declaration of conformity on December 19, 2002, *aap* Implantate AG has complied with the recommendations of the November 7, 2002 version of the German Corporate Governance Code (GCGC) as published by the Federal Ministry of Justice in the electronic edition of the Federal Gazette (Bundesanzeiger) on November 26, 2002 with the following exceptions:

The D&O policy taken out for the Management Board and Supervisory Board did not include a suitable deductible (GCGC No. 3.8 Par. 2).

The Management Board's Terms of Reference did not regulate the allocation of areas of re-sponsibility and the cooperation in the Management Board (GCGC 4.2.1 Sentence 2).

A retroactive change of the performance targets was not ruled out (GCGC 4.2.3 Sentence 5).

Compensation of the members of the Management Board was not reported in the Notes on the Consolidated Financial Statements subdivided according to fixed, performance-related and long-term incentive components (GCGC 4.2.4).

No age limit was specified for members of the Management Board (GCGC 5.1.2 Par. 2 Sen-tence 3).

No age limit was specified for members of the Supervisory Board (GCGC 5.4.1 Sentence 2).

Compensation of the members of the Supervisory Board did not include a performance-related component and did not take membership of committees into consideration. Payments made to members of the Supervisory Board were not listed individually in the Notes to the Consolidated Financial Statements (GCGC 5.4.5).

Interim reports were published in accordance with § 63 of Stock Exchange Regulations within 60 days of the end of the reporting period (GCGC 7.1.2).

Not all relationships with shareholders considered to be "related parties" pursuant to the applicable accounting regulations were noted in the Consolidated Financial Statements (GCGC 7.1.5).

In the future, *aap* Implantate AG will comply with the recommendations of the revised version of the German Corporate Governance Code dated May 21, 2003 and published by the Federal Ministry of Justice in the electronic edition of the Federal Gazette (Bundesanzeiger) on July 4, 2003 with the following exceptions:

The D&O policy taken out for the Management Board and Supervisory Board will not include a deductible (GCGC 3.8 Par. 2).

The Management Board's Terms of Reference do not regulate the allocation of responsibility and the cooperation in the Management Board (GCGC 4.2.1 Sentence 2).

Retroactive changes to performance targets or comparison parameters are not ruled out in the overall compensation of the members of the Management Board. For extraordinary, unforeseen developments a possibility of limitation (Cap) has yet to be agreed by the Super-visory Board. The salient points of the compensation system and the concrete form of a stock options scheme or comparable instruments for components with long-term incentive effect and risk elements has yet to be published on the company's website in plainly under-standable form and detailed in the annual report. The Chairman of the Supervisory Board has yet to outline the salient points of the compensation system and any changes thereto to the General Meeting (GCGC 4.2.3 Sentences 5–8).

Compensation of the members of the Management Board will not be reported in the Notes to the Consolidated Financial Statements subdivided according to fixed, performance-related and long-term incentive components, and the figure will not be individualized (GCGC 4.2.4).

No age limit has been specified for members of the Management Board (GCGC 5.1.2 Par. 2 Sentence 3).

No age limit has been specified for members of the Supervisory Board (GCGC 5.4.1 Sen-tence 2).

Compensation of the members of the Supervisory Board does not include a performance-related component and does not take membership of committees into consideration. Payments made to members of the Supervisory Board are not be listed individually in the Notes to the Consolidated Financial Statements (GCGC 5.4.5).

Interim reports will be published in accordance with § 63 of Stock Exchange Regulations within 60 days of the end of the reporting period (GCGC 7.1.2).

Not all relationships with shareholders considered to be "related parties" pursuant to the applicable accounting regulations will be noted in the Consolidated Financial Statements (GCGC 7.1.5).

Berlin, December 18, 2003

The Supervisory Board The Management Board

▶ The Management Board, after consultation with the Supervisory Board, issues the following statements on the exceptions to the German Corporate Governance Code's recommendations that it listed in its December 18, 2003 declaration of conformity:

No. 3.8:

The D&O policy is a group insurance for management in Germany and abroad for which a differentiation between Board members and other management officers (a "suitable deductible") does not seem to be appropriate. What is more, there are no currently recognized principles with regard to the suitability of a deductible or to the implication of a greater sense of responsibility and a deviation from the approach that is customary in other countries.

No. 4.2.1:

Allocation of areas of responsibility and cooperation in the Management Board have yet to be covered by the Management Board's terms of reference. Given that the Board has previously comprised only two members who coordinate their work very closely with each other and that possible changes in the Management Board are to be anticipated at any time, strict regulation in the terms of reference has yet to be considered necessary.

No. 4.2.3:

A retroactive change in performance targets has not yet been ruled out in order to be able to respond at any time to legal and/or fiscal changes. Given the current share price trend and further exacting obstacles to exercising option rights in the stock option program, a cap has so far seemed superfluous. The basic features of the remuneration system and details of the stock option program are outlined below and are published in a timely manner on the Internet. The Supervisory Board chairman will outline the remuneration system for the first time at this year's annual general meeting of shareholders.

No. 4.2.4:

Reporting individual remuneration of members of the Management Board does not provide any additional information that is of relevance for the capital market and runs counter to the Board members' entitlement to personality protection. The emphasis is on the Board's overall performance, and an assessment of the suitability of the remuneration received by an individual Board member can only be subject to knowing what individual contributions he has made toward the company's success.

Nos. 5.1.2 and 5.4.1:

Specifying an age limit for members of the Management Board and Supervisory Board for one restricts shareholders in their right to elect members of the Supervisory Board and for another limits the Supervisory Board's ability to nominate candidates it considers to be best qualified for the job. Specifying an arbitrary age limit to conform with the German Corporate Governance Code's recommendations is, moreover, not considered to be appropriate.

No. 5.4.5:

The remuneration of members of the Supervisory Board consists only of fixed components because that guarantees the supervisory body's independence in every respect. Membership of committees is not taken into consideration because it would not lead to an additional motivation. What is more, payments are not listed individually because not doing so is felt to be a suitable compromise between transparency and respect for the private sphere. Also, the Supervisory Board provides its services as an overall body, with the result that an individual listing of payments would not necessarily lead to an appropriate assessment of its members.

No. 7.1.2:

In relation to its size, the company's corporate structure is extremely complex, which can lead to an increased time requirement for compiling interim reports.

No. 7.1.5:

Taking into consideration the limits to material importance of the number of shares held by the shareholders in question, and with due respect for their private sphere, not all relationships with shareholders considered to be "related parties" will be noted in the consolidated financial statements.

In accordance with Point 4.2.3 of the German Corporate Governance Code as amended on May 21, 2003, the salient points of the compensation system for the Management and Supervisory Board of *aap* Implantate AG and the concrete form of the stock options scheme are here outlined as follows:

Remuneration of the Management Board:

Members of the Management Board receive a fixed annual sum plus a share in profits based on the published annual profits of *aap* Implantate AG taking into account § 86 of the German Stock Corporation Act (AktG). A share in profits is not paid on profits of up to 4% of annual sales revenues. On profits in excess of 4%, a profit share is paid on a geared percentage basis. Members of the Management Board also receive payment in kind such as a company car and stock options.

Remuneration of the Supervisory Board:

Members of the Supervisory Board receive in addition to payment of their expenses per meeting a remuneration of € 1,278.23 each. The chairman is paid twice this amount and the vice-chairman one and a half times this amount.

Stock Option Program:

The company's stock option program provides for the following performance goal that must be achieved before option rights can be exercised: "Stock option rights may only be exercised if the average closing price for shares in the company on the Frankfurt stock exchange over the 20 trading days prior to exercise of the option rights has been at least 20% higher than the issue price and if this price increase exceeds the percentage increase of the Frankfurt stock exchange's Prime Pharma & Healthcare Performance Index over the same period."

The options have a four-year term from their date of issue (December 1, 2000). They may only be exercised during four three-week periods in the year beginning on the day after publication of the quarterly report or the annual financial statements. Stock options are held by Board members and senior management officers of the company and associated companies and by employees of the company and associated companies. On December 31, 2003, 178,748 stock options were still outstanding.

Consolidated management report & management report by *aap* Implantate AG

Share and stock market

Price development of the *aap* share

▶ The *aap* share price reached its low-water mark of € 1.37 on March 19, 2003 and its € 5,45 peak for the year on September 11, 2003 after we reported European product approval for the bone replacement material PerOssal®. The price fell again during the fourth quarter, but not below the € 2 mark.

Finance

Consolidated development of sales revenues and results

▶ The sales and earnings trend in fiscal 2003 was unsatisfactory and well below the scheduled targets. A marked year-on-year decline in sales and earnings was due mainly to foreign markets developing badly, to extraordinary depreciation and to individual special factors. Domestic sales fell well short of expectations, too. Reluctance to place orders was caused in Germany by factors that included the introduction of flat-rate payments for hospital services and resulting hospital restructuring.

Sales revenues were down by 17.8% to € 11 million from € 13.3 million. Total operating performance was down by 14.8% to € 12.6 million from € 14.8 million in the previous year.

EBITDA before special factors arising from the reconstruction deteriorated by € 1.3 million to minus € 273,000 (previous year: € 1.03 million). The previous year's result was, however, burdened by stock options booked as expenditure totaling € 579,000. Since the blocking period for stock options issued expired in November 2002 there have been no further transfers and none are due. EBIT before acquisition-related write-downs amounted to minus € 3.175 million, or € 3.363 million below the previous year's € 118,000. After taking into account € 1.461 million in acquisition-related write-downs, EBIT took a further marked € 2.783 million tumble to minus € 4.636 million.

The DVFA/SG consolidated result for the year before special factors arising from the reconstruction and after acquisition-related depreciations was minus € 4.180 million, that was an improvement on the previous year's minus € 4.429 million, which was a consequence of income tax factors in that reporting period. DVFA/SG earnings per share after special factors were minus € 0.87 (previous year: minus € 0.93). DVFA/SG cash earnings after special factors were minus € 822,000 (previous year: minus € 1.583 million).

The marked year-on-year decline of 17.8% in sales revenues was fundamentally due to the unsatisfactory development of foreign markets. The decline in foreign sales revenues in fiscal 2003 was 38.2% (2003: € 2.549 million, 2002: € 4.123 million). By region, the Asian market accounted for € 1.594 million, or 66.0%, of this decline, due in part to the negative influence of the SARS crisis and the weakness of the US dollar. What is more, in fiscal 2002, substantial sales revenues were the result of initial equipment purchases that in the year und review were repeated neither in Asia nor in other foreign markets. Sales in the Americas were increased by 11.2% with the aid of a new U.S. sales partner. Sales in the American region totaled € 858,000 (previous year: € 771,000).

German sales growth was not up to schedule either, with a decline of 8.6%. In Germany this trend was due in part to a general reluctance to order in connection with the introduction of flat rates for hospital services as a part of healthcare reforms.

In fiscal 2003, in keeping with strategic portfolio streamlining, inventories were restructured. Inventories of innovative, new products were built up to maintain or achieve ability to supply, and old inventories were written down as a part of the portfolio streamlining. In all, the result was a € 68,000 reduction in inventories. Downward valuation adjustments undertaken, including extraordinary depreciation, total € 1.704 million, however. Taking into account the capitalization of development costs amounting to € 1.339 million and other capitalized services rendered to the Group's own account, total operating performance was € 12.591 million, which was € 2.180 million below the previous year's figure. In view of the priority given to development projects, the capitalized development costs relate mainly to product developments that are on the brink of reaching market maturity. Development costs for the following projects were capitalized: bone cement with an antibiotic, HF cement, CS balls (resorbable bone replacement material) and stable-angle plates.

The operating result was minus € 4.642 million, or a € 2.699 million year-on-year deterioration. The material costs ratio was up by 2% on the year because sales in high-margin region such as Germany, the United States and Japan were below plan and no significant sales of the innovative *aap* products launched in the past two years have yet been achieved. Personnel costs, in contrast, were reduced by means of a targeted reduction in overtime and of layoffs. That corresponded to a relative reduction of around 20.2%, and even when the previous year's € 579,000 expenditure on stock options is taken into account, personnel costs were still reduced in 2003.

Substantial increases were, however, recorded in other operating expenses. Their share of total operating performance increased to 43.5% from 34.8%. The main factors here were higher costs for sales and marketing. Depreciations totaling € 4.363 million represented a € 1.483 million increase on the previous year. Nonscheduled depreciations totaling € 300,000 were made on property and buildings due to a restriction in their usefulness that had arisen. Finally, € 786,000 in accounts payable was effectively written off because the debtor was unlikely to be able to pay in the short or medium term.

The financial result was minus € 1.123 million, or € 131,000 down on the year. Of a total of € 11.608 million in extraordinary expenses, € 11.236 million was due to the strategic realignment of the *aap* group (for further details, see below). A further € 372,000 in extraordinary expenses resulted from composition agreements in the year under review that granted the contributing shareholders in the Mebio/Coripharm Group of companies discounts in connection with the repayment of warranty breaches.

After this, the company showed a pre-tax result of minus € 17.471 million. Along with the extraordinary write-down requirement totaling € 11.236 million due to the strategic realignment of the *aap* Group (for further details, see below), the result for the financial year was burdened additionally by the following special factors: The company is engaged in litigation with HJS Gelenk-System GmbH, Munich. In connection with a suit filed by HJS Gelenk-System GmbH a precautionary provision amounting to € 765,000 was made for the risks and costs of the case, which involves damages claimed for sales figures for the "knee joint" license agreement that were not achieved, poor performance of the "knee joint" development contract, and alleged contractual penalties for delay in U.S. and Japanese approval of the knee implant developed by *aap* Implantate AG. The company's view is that this delay was due to changes in design made necessary by faulty specifications provided by HJS Gelenk-System GmbH. The product has already gained CE approval and has been implanted successfully. For foreign currency risks due to the weakness of the U.S. dollar in connection with a foreign sales contract, impending losses were anticipated and a € 200,000 provision was made. In connection with the portfolio streamlining that is underway or based on outreach analyses conducted, an additional € 440,000 marketability write-down of inventory was made and affects the result. In all, earnings before taxes are therefore burdened by one-off special factors totaling € 14.099 million. Without these special factors and acquisition-related depreciations, the result before income and sales taxes is minus € 1.914 million. Taking into account € 2.050 million in deferred income and sales taxes, the consolidated result after taxes is minus € 15.422 million.

Note on the extraordinary write-down requirement due to the strategic realignment of the *aap* Group

▶ Based on talks and negotiations with investors that had been under way since mid-2003 and took concrete shape from mid-April 2004, and on the resulting critical review of business strategy, a consolidation concept was devised. Along with the implementation of reconstruction measures (strategic focusing and recapitalization), the strategic realignment of *aap* required appropriate adjustments to balance sheet values.

The following strategic adjustments are prerequisites for the recapitalization of *aap*:

1. Focused development of competencies and of the product portfolio

aap is to continue to rely on the six competency areas knee, hip, shoulder, trauma, bone cement and biomaterials. However, to ensure a better use of resources and to focus on products that promise results in the short and medium term, the following strategic adjustments in the product area are to be taken into account:

a. The knee competency will be expanded initially without the ÆQUOS® knee endoprosthesis, but with products that are already on the market and with knee implants now in development, along with bone cements and cementing techniques. Shelving ÆQUOS® leads to € 1.167 million in extraordinary depreciation.

b. The bone cement competency will also be expanded with a clear focus on products already on the market and on bone cements that will shortly be ready for the market. R & D projects relating to new-generation bone cements such as HA cement will not be actively pursued for the time being. This strategic decision leads to € 2.095 million in extraordinary depreciation.

c. The biomaterials competency will be expanded with a clear focus on resorbable bone substitutes. Given the presence of rival products on the market and information obtained about the market, non-resorbable bone substitutes such as Cerabone and Cerabone granules are no longer to be pursued intensively. This strategic realignment involves extraordinary depreciation of € 4.031 million.

d. To streamline the range of products and reduce complexity, the product portfolio will be trimmed. Sales and marketing activities will concentrate mainly on A product groups and on the new growth engines. Various older products are to be removed from the program. This leads to extraordinary inventory write-downs totaling € 844,000.

2. Streamlining of group structure

The present group structure will be trimmed as quickly as possible and adjusted to the Group's size. The company will press ahead quickly with corporate restructuring. In addition to reducing the complexity of corporate processes, the primary goal will be to concentrate the image of the entire group of companies on the "*aap*" umbrella brand. This means no further value is attached to the other *aap* Group brands. Following this strategic decision, the goodwill of subsidiaries Corimed and Mebio, totaling € 3.099 million, was written off entirely.

Overall, the aforementioned strategic adjustments led to valuation corrections totaling € 11.2 million in the *aap* Group's consolidated financial statements to IFRS.

Consolidated balance sheet development

▶ The balance sheet structure has changed markedly as against December 31, 2002 due to extraordinary adjustments, of which € 10.392 million is to fixed assets, which decreased by a total of € 12.175 million. Write-downs include in particular the full write-off of goodwill in Mebio GmbH (€ 3.099 million) and downward valuation adjustments to patents (€ 5.760 million). Further extraordinary depreciation of € 300,000 relates to real estate. Scheduled depreciation in the financial year amounted to € 3.210 million. Investments in fixed assets totaling

€ 1.921 million consisted for the most part of € 1.339 million in capitalized development costs and of office and plant equipment. Inventories decreased markedly from December 31, 2002, to € 6.779 million (previous year: € 8.214 million). This reduction is essentially attributable to higher write-downs due to limited salability and extraordinary downward value adjustments undertaken in connection with the strategic trimming of the product portfolio.

Trade receivables were down by € 1.230 million on the Dec. 31, 2002 figure, due mainly to the decline in sales.

Deferred taxes increased by € 2.213 million due to the negative result. However, for the most part the extraordinary strategic downward valuation measures had no tax consequences. The company's equity ratio is 23%. In the second quarter a capital increase was agreed, leading to an inflow of € 200,000 in funds. It was entered in the commercial register in the third quarter.

Repayment of money owed to banks was partly suspended in fiscal 2003 as agreed with the creditors. Trade accounts payable increased by € 417,000 due to the Group's tight liquidity position. Advance payments received increased by € 311,000 in consequence of prepayments by Chinese and U.S. sales partners. Downpayments made by the Chinese sales partner are quarterly payments for orders to be processed during the quarter in progress. Other liabilities were reduced by € 642,000.

Financial position

▶ The *aap* Group's liquidity position was extremely tight throughout the year under review. A financial balance was maintained by means of the following measures. Repayment of money owed to banks was largely waived in fiscal 2003 as agreed with the creditors. The Group's banks granted the parent company a new loan totaling € 450,000. Prolongation or installment agreements were concluded with the main suppliers. The capital increase agreed in the second quarter led to an inflow of € 200,000 in new funds. Strict cost and receivables management improved liquidity control, and as a result it has been possible to maintain the Group's solvency at all times.

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 a marked decline in sales of 49% to € 5.485 million, a minus € 4.861 million deterioration of the operating result to minus € 3.447 million, and a net loss for the year of minus € 6.805 million (previous year: minus € 122,000).

Markedly lower sales were posted in comparison with the previous year, partly due to the settling of accounts in 2002 for a research and development order for a new knee implant that we had been working on for several years. Yet even after adjustment for the positive effect of this contract, sales were down markedly, as was operating result, in the year under review. That was due mainly to the above-mentioned special factors that all affected *aap* Implantate AG. Of the extraordinary downward valuation adjustments due to the strategic realignment of the *aap* Group, € 1.651 million is reported in *aap* Implantate AG's financial statement drawn up under German commercial law, affecting license rights shown under fixed assets (€ 807,000), and inventories (€ 844,000). Further special factors totaling € 2.491 million consist of provisions for litigation and the write-off of accounts receivable.

In addition, further factors with a negative effect on net income burdened the result in connection with the change in strategy initiated in respect of the U.S. market and with the decrease in valuation of the GEOT shareholding.

Balance sheet development at *aap* Implantate AG

The balance sheet structure changed in comparison with Dec. 31, 2002, essentially due to extraordinary downward valuation adjustments. Fixed assets decreased by a total of € 1.662 million, of which € 807,000 was due to the extraordinary write-down of the ÆQUOS® license. Investment in fixed assets totaling € 685,000 was down on the year due to the company's tight liquidity position and consisted mainly of internally produced plant and equipment. In the year under review, inventories were reduced to € 5.989 million (previous year: € 7.295 million) due to higher salability write-downs and extraordinary downward valuation adjustments in view of the strategic trimming of the product portfolio. Receivables from affiliated and associated undertakings increased by € 171,000 to € 778,000 in the year under review. A key item among other assets is the warranty claim against the contributing shareholders in the Mebio/Coripharm Group of companies.

aap Implantate AG's equity quota is 24% (previous year: 46%) and was therefore reduced substantially by the net loss for the year. The increase in provisions is attributable to the risks and costs of litigation in connection with the suit filed by HJS Gelenk-Systeme GmbH and to foreign currency risks. Current accounts payable for goods and service and advance payments received were also up on the previous year.

Subsidiaries Mebio, Corimed und Coripharm

aap subsidiaries Mebio, Corimed and Coripharm 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 *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 15 patents in the above-mentioned business fields and an international network of recognized research scientists and practicing physicians.

The situation at *aap* Implants, Inc.

After redrafting of the business strategy for the U.S. market, the *aap* sales concept for this market envisions a niche policy. A network of dealers is to sell selected products with a clearly unique selling position in the U.S. market. The first dealer in selected osteosynthesis products commenced activities last fiscal year. In the bone cement segment, Smith & Nephew is an important exclusive distributor of the *aap* product VERSABOND™.

After *aap* Implants, Inc. ceased operative business in mid-2003, the subsidiary's closure was agreed and its winding-up was commenced.

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 2005 at the latest.

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-osteo-stimulation. Electro-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. In 2002, the entire GEOT product range was granted CE approval.

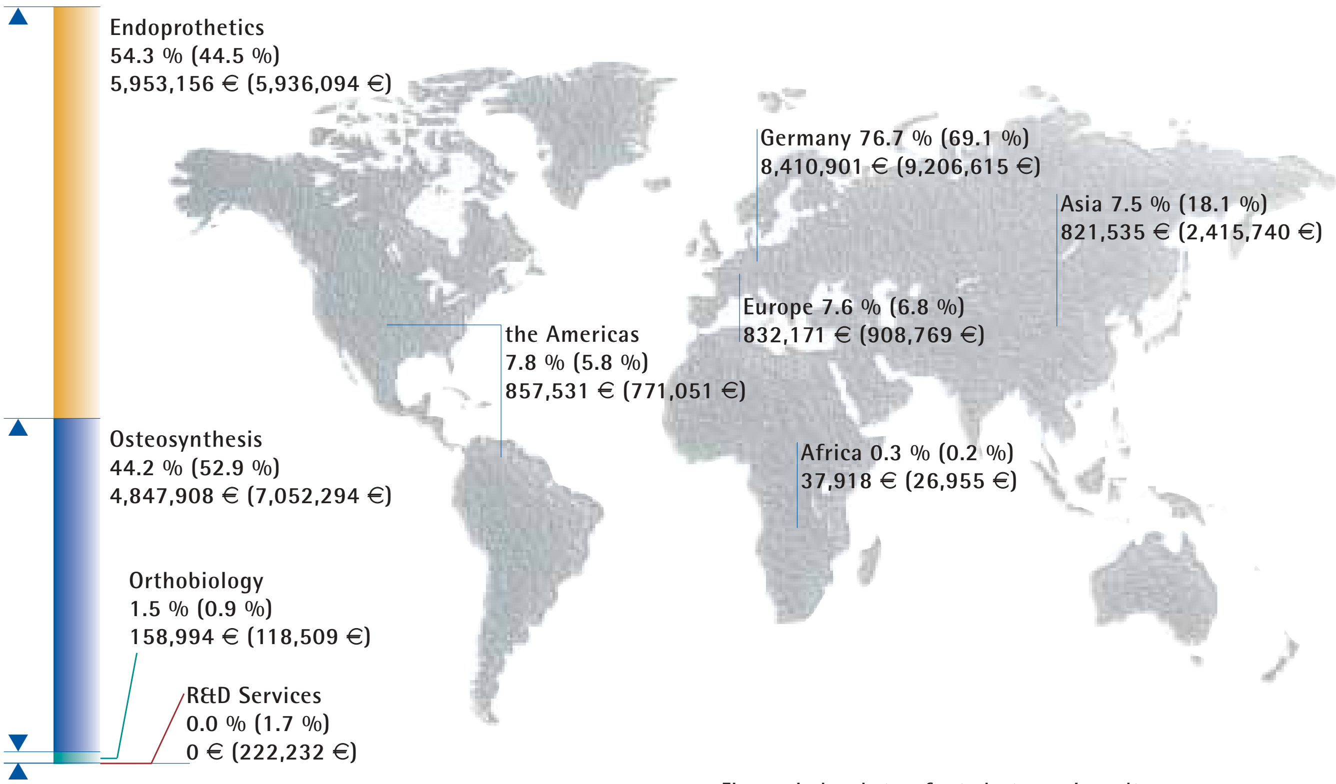
In spite of the efforts that *aap* has made to place GEOT products in the market, the successes achieved have been well below expectations, due in part to the need to explain the products. In view of the portfolio streamlining on which *aap* has embarked or of the focus on marketing innovative products of its own, *aap* no longer markets this product actively.

Employees

▶ The number of employees at *aap* Implantate AG on Dec. 31, 2003 was 80, of whom 72 were full-time, 7 part-time and 1 was temporary (previous year: 86, of whom 74 were full-time, 8 part-time and 4 temporary). Across the group, the *aap* Group of companies employed on Dec. 31, 2003 102 employees, including 89 full-time, 11 part-time and 2 temporary (previous year: 108, of whom 92 were full-time, 11 part-time and 5 temporary).

The large number of trainees at *aap* – 14 employees, or 17.5% of the payroll – underscores our special commitment to training highly qualified juniors, with especial emphasis on training industrial mechanics in the production sector.

Products, markets & sales



Figures in brackets refer to last years' results.

Sales distribution in the *aap* Group

▶ Endoprosthetics and osteosynthesis continued in fiscal 2003 to be the *aap* Group's main lines of business. The endoprosthetics segment's share of total sales amounted to 54.3% (previous year: 44.5%) and that of osteosynthesis 44.2% (previous year: 52.9%). Endoprosthetics took over for the first time last year as the largest line of business, due mainly to the marked sales decline in osteosynthesis, and especially to sales losses in Asia. The bone cement and cementing techniques business – a part of endoprosthetics – showed a more stable, not to say growth trend. The other two segments, orthobiology and R&D services, do not yet account for significant shares of sales, totaling 1.5% (previous year: 0.9%) and 0.0% (previous year: 1.7%) respectively.

The lion's share of consolidated sales revenues totaling around € 11 million, 76.7% (previous year: 69.1%), was earned in Germany. Foreign sales broke down as follows: Europe 7.6% (previous year: 6.8%), Asia 7.5% (previous year: 18.1%), the Americas 7.8% (previous year: 5.8%) and Africa 0.3% (previous year: 0.2%).

Sales distribution at *aap* Implantate AG

▶ Osteosynthesis and endoprosthetics were the principal lines of business at *aap* last fiscal year. Their shares of total sales revenues were 85.6% (previous year: 62.1%) and 14.4% (previous year: 9.8%). The R&D services segment that in 2002 still accounted for 28.1% of sales made no contribution toward sales last year.

The lion's share of consolidated sales revenues of € 5.5 million, 72.9% (previous year: 70.5%), was earned in Germany. It totaled around € 4.0 million and was therefore 47.4% lower than the previous year's € 7.6 million. Further sales were made in Europe (8.4%, previous year: 4.3%), Asia (14.9%, previous year: 22.4%), the Americas (3.1%, previous year: 2.5%) and Africa (0.7%, previous year: 0.2%).

As at Dec. 31, 2003, the new order backlog totaled € 262,000 (previous year: € 177,000). In principle, the company endeavors to provide its customers with a 24-hour delivery service and is therefore characterized in principle by a relatively low order backlog. In 2003, *aap* was able to realize 80% of its deliveries within 24 hours.

Sales and marketing activities

▶ Aggressive competition in the market for bone cement and cementing techniques continued in fiscal 2003. The nonetheless slightly positive sales trend in these product areas demonstrates, however, that *aap* was still able to counteract this competitive situation successfully.

Intensified market penetration of the EASYMIX® cementing system in Europe spearheaded by Essex Chemie AG, Lucerne, Switzerland, and other sales dealers in Italy and Eastern Europe was reflected in the sales figures for the first time in the second half of 2003.

Marketing and sales activities for the bone replacement materials Cerabone® and Ostim®, manufactured by subsidiary Coripharm and associated enterprise Osartis respectively, generated in fiscal 2003 sales in the forward-looking orthobiology segment, but these revenues were below expectations.

Business in Asia, which fell well short of expectations due to the SARS epidemic and weakness of the U.S. dollar, showed signs of a slight recovery at the end of 2003 as a result of the conclusion of a purchase contract for the fourth quarter of 2003 and the year 2004.

Activities in the United States were characterized by the liquidation of the previous U.S. business in the trauma segment and by the establishment of a basis for the revised sales strategy in the world's largest orthopedics market.

In 2003, *aap* Implantate AG attended a wide range of national and international trade fairs and congresses. Highlights were the annual congress of German Accident Surgeons (DGU) in combination with the German Orthopedics Congress held in Berlin in November, and participation in the world's largest medical trade fair, Medica, in Düsseldorf. The new products that *aap* envisioned as growth motors for 2004 – VarioFit®, PerOssal® and stable-angle plates – were here presented to international specialists for the first time. The positive response confirmed for us the market opportunities that these new products presented.

At international congresses, too, we were able to make important contacts for foreign business, such as by attending the Iranian Orthopedists' Congress in October 2003, Eurospine and the Swiss Orthopedists' Congress. SOFCOT, which is very international in alignment, was another important forum, especially for addressing interested parties from French-speaking countries.

Research & Development

Osteosynthesis

▶ With the completion of the design for new plates and their transfer to series production the market has since the beginning of 2004 had an innovative, stable-angle plate system at its disposal. The protected, spherical thread at the head of the screw and in the plate holes makes safe plate osteosynthesis possible even with reduced bone quality in for the time being two treatment areas. In 2003 too, then, we succeeded in extending and enlarging continuously our innovative product range in the osteosynthesis and traumatology areas.

Endoprosthetics

▶ In endoprosthetics, too, another strategically significant product, the VarioFit® hip endoprosthesis, reached series maturity.

In 2003, development of a monocondylar, i. e. minimally invasive, one-sided surface replacement, was intensified with a view to starting series production in 2004. *aap* would thereby complete its product portfolio in the area of endoprosthetic treatment of the human knee joint.

For a new bone cement with alternative additives, main trials were conducted and evaluated in collaboration with a renowned university after analysis of the first pilot tests. Test batches of another innovative bone cement were prepared and examined and analysed for the range of uses to which they could be put.

Orthobiology

▶ European approval was secure in September for a newly developed synthetic bone replacement material, PerOssal®. In collaboration with universities, clinical trials were planned.

As part of a joint project financed by the German Ministry of Education, Science, Research and Technology, initial studies were undertaken in collaboration with another partner to develop carrier materials for artificial cartilage and bone tissue.

Production & procurement

▶ A new production method needed to be developed for the spherical thread of stable-angle plates that were unveiled at the congress of German Accident Surgeons (DGU). Here too, work is carried out directly from design data. Production processes are scheduled for further optimization and the product range for extension in 2004.

The VarioFit® hip prosthesis that the *aap* Group is marketing as a commercial product was included in the product portfolio and is to be joined in 2004 by a model with a fixed cone.

Quality and Environmental Management

▶ U.S. approval of AcroPlate®, a plate used to treat lateral clavicular fractures, was secured at the beginning of the second quarter of 2003.

The documentation required for approval in the United States of the ÆQUOS® knee endoprosthesis was submitted in the fourth quarter of 2003.

aap Implantate AG decided to convert its quality management system in the third quarter of 2004 to the DIN EN ISO 13485 standard that is relevant for manufacturers of medical products. No changeover of the QM system to the revised DIN EN ISO 9001:2000 standard is planned at present.

In January 2004, both the annual audit by Dekra ITS Certification Services GmbH and an inspection by the U.S. Food and Drug Administration (FDA) took place.

Outlook and prospects

▶ After a 2003 that came well below expectations, our aim is by means of significant sales and earnings improvements to achieve the turnaround, not taking acquisition-related depreciation into account, in 2004.

The *aap* business model is aimed at establish the six competencies trauma, shoulder, hip, knee, bone cement and cementing techniques, and orthobiology in development, manufacturing and marketing. Our vision is to achieve market leadership as an integrated orthopedics enterprise with a competency in case-related quality- and cost-optimized treatments.

The priority objective of *aap*'s sales and marketing strategy in 2004 is to market the product systems it has developed successfully in Germany and other countries. The sales focus will be on Germany, our main sales region. In other countries, the focus will also be on high-volume, high-margin regions. Priority will here be given to Europe, China and the United States, where selling of selected products is to go ahead.

In the future we hope to achieve significant sales and earnings growth by means of intensifying and extending sales, especially of the bone replacement material PerOssal®, approved in September 2003, of stable-angle plates and of the bone cement VERSABOND™. These growth motors are to take forward the establishment of competencies.

PerOssal® is a bone replacement material to fill and reconstruct bone defects and at the same time to stimulate healing of fractures and bone growth. Due to its total resorbability as a result of the Ostim® nanocrystalline hydroxylapatite paste that it contains, the bone defect can be restored swiftly with new bone of the patient's own, thereby sparing him or her further surgery to remove the implant. PerOssal® can also take in agents such as antibiotics in liquid form and release them step by step over a predefined period. In combination with its existing products Cerabone® and Ostim®, *aap* is extending its competency in orthobiology decisively with PerOssal®.

VarioFit® is a two-part hip endoprosthesis shaft that by means of variable combinations of the hip shaft with four different conuses can be adapted optimally to the patient's anatomical requirements. The required angles, established pre-operatively, are set by means of a patented raster system. A special set of instruments ensures that surgery is easy on the patient and that the implant is positioned precisely.

Both the humerus and the radius fixature plates have spherical threads at the head of the screw and in the hole in the plate to ensure angular stability. The plate is thereby fixed permanently and finds a hold even in osteoporotic bone. This property offers the physician the opportunity to start practicing exercises with the patient immediately after the operation and thereby to reduce the rehabilitation period. What is more, the spherical shape of the thread holes makes it possible to use much less expensive standard screws. We are thereby attempting at the same time to take growing cost pressure in the healthcare system into account.

As a result of successful 2002 product changes to the bone cement VERSABOND™ and of its product approval inclusive of an antibiotic, scheduled for 2004 in the United States, and the subsequent world launch of the product by our partner Smith & Nephew we here anticipate further significant increases in sales revenues.

There are no signs of a stabilization of price competition in the market for bone cements and cementing systems. Although relatively low gross yields must continue to be anticipated, there is in our view and assessment of the market no threat to the competitiveness of Mebio in the endoprosthetics segment, given the satisfactory market penetration of Palacos® R bone cement and the new EASYMIX® system.

Risks inherent in 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 entrepreneurial 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.

In a contract dated end of May 2004, *aap* concluded agreements with a group of German and Swiss financial investors and with its existing banks for reorganizing and recapitalizing the company. These agreements on the proposed capital procurement measures are subject to, among others, the following conditions precedent:

- BAFin exemption from compulsory offer,
- Entry in the register of companies of a resolution by the Annual General Meeting for the financial year 2004 authorizing a cash capital increase of at least € 8 million.

If these capital measures should fail due to non-fulfillment of the conditions precedent or for other, as yet unforeseeable reasons, the company plans further structural adjustments that will involve both downsizing and, logically, selling off assets. If these measures too cannot be realized in the short term, the company will then find itself in a position in which, given the current tight liquidity, its survival is under threat.

As a medical technology company, *aap* needs national and/or international approvals for its products. That is why changes to national statutory requirements for these approvals and possible delays in approval procedures constitute risks for *aap*.

The company's economic development also depends on developments in the healthcare system. Global concentration processes and cyclical stagnation can here exert a substantial influence.

Exchange rate risks that beset an international sales strategy can also influence *aap*'s success. We try to counteract as far as possible this risk and the risk of international payment flows in general by billing almost exclusively in euros, by limiting credit facilities and by using other receivables safeguards such as bank guarantees and payment in advance.

Orthobiology is a line of business that is still under construction at *aap*, and that too involves risks. This research- and marketing-intensive new area requires substantial amounts of both human and financial capital. On the one hand there is a risk that not all current and proposed product developments in this line of business can be converted successfully into market-ready products. On the other, success in the new orthobiology segment will depend to a decisive extent on whether *aap* can convert research results into marketable products, establish approved products before its competitors do so, and market them faster than the competition.

Reporting as per § 289 Par. 2 of the German Commercial Code (HGB)

Events of special significance after the end of the fiscal year (§ 289 Par. 2 No. 1 HGB)

▶ In view of legal disputes between HJS Gelenk-System GmbH and *aap*, HJS has canceled for cause both the development and the license agreement on an artificial knee joint.

For the original ÆQUOS® knee joint, sales in the lower six-digit region were planned for fiscal 2004. Given that the product launch involves high market launch costs, postponement of the product launch for a modern knee system does not have any significant effect on fiscal 2004 in terms of reducing results. Work is currently in progress on a modification of our tried and tested Mebio knee. In the process, market know-how combined with innovative production technology will lead to a new implant that as planned at present will be able to bridge the gap left by discontinuation of the ÆQUOS® knee joint. The product launch will, as currently estimated, be postponed by around six months.

The sales capacities that have become available as a result can be used to launch our minimally invasive, implantable monocondylar knee joint replacement (onesided replacement of destroyed joint surfaces), to modify the existing standard knee and to take our knee competency further forward by means of new cements and cementing techniques, thereby offsetting much of the sales shortfall.

In a contract dated May 27, 2004, *aap* concluded agreements with a group of German and Swiss financial investors and with its existing banks for reorganizing and recapitalizing the company.

Anticipated development of the company

▶ Securing corporate financing is still crucial to the further systematic implementation of restructuring measures and consistent implementation of the business model. The company needs more capital to reduce existing historic liabilities, to market its growth products and to drive forward the creation of competencies as the core idea of the business model.

Subject to approval by the General Meeting of Shareholders and to the successful implementation of a capital increase, these agreements will furnish the company with new liquidity and almost eliminate its dependence on banks.

This concept is based on the one hand on investors guaranteeing a cash capital increase for the company of at least € 8 million and for a maximum of € 10 million. In addition, a bridging loan of € 800,000 to be secured by the investors will ensure the company's liquidity. On the other, once the cash capital increase is successfully implemented, *aap* undertakes to repay more than € 10 million of existing debts to banks at a reduced rate of approximately € 5 million.

The aforementioned agreements with investors also included changes in the company's management and in the group's strategic alignment.

The successful conclusion of these capital measures enables *aap* to press ahead with its business strategy as an integrated orthopedics enterprise that systematically builds up the six competency areas Trauma, Hip, Knee, Shoulder, Bone Cements and Biomaterials. In addition to stepping up sales and marketing activities in Germany and abroad in connection with previously launched products, the focus will be on launching the new innovative products VERSABOND™, Ostim®, PerOssal®, VarioFit® and stable-angle plates successfully on the market.

The partial remission of debt by the company's capital providers will bring significant reconstruction gains that do not affect liquidity. In addition, while implementing the reconstruction concept important legal foundations could be laid for settling the dispute with the contributors of the Mebio/Coripharm Group.

Concluding remark

▶ After successful completion of the measures agreed with investors and banks, the company is almost free from debt and has positive net liquidity at its disposal. This has laid the foundation for positive development of the company.

The market in which *aap* operates forms a further basis for the company to develop positively in the future. Healthcare 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 well-filled product pipeline we see ourselves as being well positioned, especially after the restructuring measures successfully implemented during the period under review.

Berlin, May 28, 2004
The Management Board

Dipl.-Ing. Uwe Ahrens

Dipl.-Ing. Bruke Seyoum Alemu

Consolidated Annual Financial Statement

Consolidated Balance Sheet

to IFRS

ASSETS	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
▶ **A Fixed Assets**	**(1)**		
I. Intangible assets			
1. Concessions, industrial property rights and similar rights and values, and licenses thereto		5,552,799.32	13,709
2. Goodwill		1.00	3,362
3. Capitalized services rendered for own account		3,162,110.17	2,956
		8,714,910.49	**(20,027)**
II. Tangible assets			
1. Land and leasehold rights and buildings, including buildings on third-party land		958,521.00	1,354
2. Plant and machinery		1,810,716.92	2,074
3. Other fixtures and fittings, tools and equipment		969,921.22	1,080
		3,739,159.14	**(4,509)**
III.Financial assets			
1. Investments valued at equity	(20)	283,413.08	382
2. Other loans		293,362.91	290
		576,775.99	**(672)**
▶ **B Current assets**			
I. Inventories			
1. Raw materials and supplies		884,716.07	1,039
2. Work in progress		1,069,990.62	1,021
3. Finished goods and goods for resale		4,824,756.97	6,154
		6,779,463.66	**(8,214)**
II. Accounts receivable and other assets	(2)		
1. Accounts receivable (trade debtors)		736,393.34	1,966
2. Due from undertakings with which the company is linked by virtue of participating interests		356,965.67	357
3. Other assets		2,085,302.57	3,747
		3,178,661.58	**(6,070)**
III. Checks, cash in hand and on deposit with Deutsche Bundesbank, postal giro balances, cash in other banking accounts		85,017.00	691
▶ **C Prepayments and accrued income**	**(3)**	**3,628,764.16**	**1,416**
Total		**26,702,752.02**	**41,598**

T€ corresponds to € 1,000

EQUITY AND LIABILITIES	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
▶ A **Capital Stock**	**(4)**		
I. Subscribed capital		4,869,529.00	4,764
II. Capital reserve		24,420,203.21	24,543
III. Revenue reserve			
1. Legal reserve		41,703.95	42
2. Other revenue reserve		272,207.59	272
IV. Net income/Net loss for the year		-23,055,544.96	-7,639
V. Adjustment item for interests held by parties outside the Group		-274,585.08	-269
		6,273,513.71	**(21,713)**
▶ B **Long-term liabilities**	**(6)**		
1. Special items for investment grants		373,815.69	492
2. Long-term provisions		0.00	0
3. Due to banks		5,792,020.47	2,276
4. Long-term financial leasing liabilities		68,883.88	289
5. Due to undertakings with which the company is linked by virtue of participating interests		0	0
6. Other long-term liabilities		1,495,113.53	3,084
		7,729,833.57	**(6,141)**
▶ C **Short-term liabilities**	**(6)**		
1. Short-term provisions	(5)	1,893,990.25	1,025
2. Due to banks		4,757,254.01	8,565
3. Short-term financial leasing liabilities		220,667.87	318
4. Advances from customers		487,991.98	177
5. Accounts payable		2,276,649.18	1,860
6. Due to undertakings with which the company is linked by virtue of participating interests		9,914.72	9
7. Other liabilities		3,052,936.73	1,790
		12,699,404.74	**(13,744)**
Total		**26,702,752.02**	**41,598**

Contingent liabilities (21) € 1,039,882.29 (previous year: € 1,040,000)

T€ corresponds to € 1,000

Consolidated Income Statement

to IFRS

	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
1. Sales revenues	(7)	10,960,056.93	13,329
2. Increase in finished goods inventories and work in process		-68,295.97	-73
3. Capitalized cost of self-constructed assets		1,698,957.94	1,514
4. Other operating income	(8)	552,531.55	683
5. Cost of materials			
a) Cost of raw materials, consumables and supplies, and of purchased materials		-3,898,603.60	-4,213
b) Expenditures on bought in services		-177,522.25	321
		-4,076,125.85	**(-4,534)**
6. Personnel expenses	(9)		
a) Wages and salaries		-3,263,614.64	-4,187
b) Social security and other pension costs		-605,508.15	-653
		-3,869,122.79	**(-4,840)**
7. Depreciation	(10)		
a) of intangible fixed assets		-3,510,207.36	-2,880
b) of current assets		-853,100.13	0
		-4,363,307.49	**(-2,880)**
8. Other operating expenses	(11), (14), (15)	-5,479,424.88	-5,142
9. Investment income	(12)	-98,265.40	-134

T€ corresponds to € 1,000

Continuation	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
10. Income from loans of financial assets	(13)	17,243.54	23
11. Other interest and similar income	(13)	26,781.07	26
12. Other interest and similar expenses	(13)	-1,167,370.41	-1,304
13. Results from ordinary activities		**-5,866,341.76**	**-3,332**
14. Extraordinary expenses	(16)	-11,608,101.57	0
15. Extraordinary result		-11,608,101.57	0
16. Taxes on income	(17)	2,049,627.65	-1,188
17. Other taxes		2,913.19	0
18. Net loss for the year		-15,421,902.49	-4,520
19. Share of interests held by parties outside the Group		5,600.79	90
20. Carryover from previous year		-7,639,243.26	-3,210
21. Consolidated balance sheet loss		**-23,055,544.96**	**-7,640**

T€ corresponds to € 1,000

Consolidated Cash Flow Statement

to IFRS

	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		T€	**T€**
1. Net income/net loss for the year		-15,422	-4,520
2. Stock option expenses not affecting payments		0	579
3. Depreciation of fixed assets including accounting at equity		14,000	3,014
4. Decrease/increase in provisions		868	353
5. Loss from retirement of fixed asset items		100	26
6. Increase in inventories, trade receivables and other assets		2,114	2,931
7. Decrease/increase in trade accounts payable and other liabilities		193	-795
8. Income from retransfer of special item for investment allowances		-118	-34
9. Inflow/outflow of funds from current business activity	**(F.19)**	**1,735**	**1,554**

T€ corresponds to € 1,000

Continuation	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		T€	T€
10. Amounts paid out for capital investment		-1,921	-1,810
11. Amounts paid out for investment in financial assets		-3	-79
12. Inpayments from retirement of financial assets		0	77
13. Inflow/outflow of funds from investment activity		**-1,924**	**-1,812**
14. Inpayments form capital increases and shareholder contributions		200	0
15. Equity procurement transaction costs		-87	0
16. Inpayments from the take-up of loans		996	1,492
17. Loan repayments		-1,288	-1,711
18. Inflow/outflow of funds from financing activity		**-179**	**-219**
19. Financial resources at start of period		690	1,244
20. Exchange rate-related changes	(B.2)	-237	-77
21. Financial resources at end of period	**(B.2)**	**85**	**690**

T€ corresponds to € 1,000

Consolidated Schedule of Assets

to IFRS

	HISTORIC COST OF ACQUISITION		
	STATUS AS AT ▶ 1.1.2003	ADDITIONS	RETIREMENTS
	€	€	€
▶ **A. Fixed assets**			
I. Intangible assets			
1. Industrial property rights and similar rights and values	17,189,153.36	47,029.88	42,671.34
2. Goodwill	4,018,037.22	0.00	0.00
3. Capitalized development costs	3,144,742.98	1,338,577.25	15,511.14
	24,351,93.56	**1,385,607.13**	**58,182.48**
II. Tangible assets			
1. Land and buildings	1,745,034.99	1,573.86	0.00
2. Technical plant and machinery	5,468,374.65	189,581.78	0.00
3. Other fixtures and fittings, tools and equipment	3,742,255.84	343,923.58	105,993.52
	10,955,665.48	**535,079.22**	**105,993.52**
III.Financial assets			
1. Participations	679,299.68	0.00	0.00
2. Other lendings	290,158.13	3,204.78	0.00
	969,457.81	**3,204.78**	**0.00**
Total	**36,277,056.85**	**1,923,891.13**	**164,178.00**

Consolidated Financial Statement

Movements in Equity and the Shares of Other Shareholders to IFRS

	SUBSCRIBED CAPITAL	CAPITAL-RESERVE	STATUTORY REVENUE RESERVE
	€	€	€
Status as at 01.01.2001	3,800,000.00	9,370,989.44	41,703.95
Capital increase	964,265.00	13,788,982.08	–
Transfer according to § 272 (2) No. 2 HGB	–	803,991.69	–
Deficit for the year	–	–	–
Status as at 31.12.2001/01.01.2002	4,764,265.00	23,963,963.21	41,703.95
Transfer according to § 272 (2) Nr. 2 HGB	–	579,404.00	–
Deficit for the year	–	–	–
Status as at 31.12.2002	4,764,265.00	24,543,367.21	41,703.95
Capital increase	105,264.00	94,736.00	–
Transaction costs	–	-217,900.00	–
Deficit for the year	–	–	–
Status as at 31.12.2003	4,869,529.00	24,420,203.21	41,703.95

Conditional capital: € 476,000.00

		CUMULATIVE DEPRECIATION					BOOK VALUES	
	STATUS AS AT ▶ 31.12.2003	STATUS AS AT ▶ 1.1.2003	DEPRECIATION FISCAL YEAR	EXTRAORDINARY DEPRECIATION	RETIREMENTS	STATUS AS AT ▶ 31.12.2003	STATUS AS AT ▶ 31.12.2003	STATUS AS AT ▶ 31.12.2002
	€	€	€	€	€	€	€	
	17,193,511.90	3,480,416.79	1,593,263.95	6,567,031.84	0.00	11,640,712.58	5,552,799.32	13,708,736.57
	4,018,037.22	655,626.23	263,713.84	3,098,696.15	0.00	4,018,036.22	1.00	3,362,410.99
	4,467,809.09	188,879.09	390,661.89	726,157.94	0.00	1,305,698.92	3,162,110.17	2,955,863.89
	25,679,358.21	**4,324,922.11**	**2,247,639.68**	**10,391,885.93**	**0.00**	**16,964,447.72**	**8,714,910.49**	**20,027,011.45**
	1,746,608.85	390,609.99	397,477.86	0.00	0.00	788,087.85	958,521.00	1,354,425.00
	5,657,956.43	3,394,674.39	452,565.12	0.00	0.00	3,847,239.51	1,810,716.92	2,073,700.26
	3,980,185.90	2,661,800.95	412,524.70	0.00	64,060.97	3,010,264.68	969,921.22	1,080,454.89
	11,384,751.18	**6,447,085.33**	**1,262,567.68**	**0.00**	**64,060.97**	**7,645,592.04**	**3,739,159.14**	**4,508,580.15**
	679,299.68	297,621.20	98,265.40	0.00	0.00	395,886.60	283,413.08	381,678.48
	293,362.91	0.00	0.00	0.00	0.00	0.00	293,362.91	290,158.13
	972,662.59	**297,621.20**	**98,265.40**	**0.00**	**0.00**	**395,886.60**	**576,775.99**	**671,836.61**
	38,038,771.98	**11,069,628.64**	**3,608,472.76**	**10,391,885.93**	**64,060.97**	**25,005,926.38**	**13,030,845.62**	**25,207,428.21**

	REVENUE RESERVES				
	OTHER REVENUE RESERVE	BALANCE-SHEET LOSS/PROFIT	SHARES OWNED BY THE GROUP	SHARES OWNED BY OTHER SHAREHOLDERS	TOTAL
	€	€	€	€	€
	272,207.59	162,198.13	13,647,099.11	-157,834.68	13,489,264.43
	–	–	14,753,247.08	–	14,753,247.08
	–	–	803,991.69	–	803,991.69
	–	-3,372,165.83	-3,372,165.83	-20,693.45	-3,392,859.28
	272,207.59	-3,209,967.70	25,832,172.05	-178,528.13	25,653,643.92
	–	–	579,404.00	–	579,404.00
	–	-4,429,275.56	-4,429,275.56	-90,456.16	-4,519,731.72
	272,207.59	-7,639,243.26	21,982,300.49	-268,984.29	21,713,316.20
	–	–	200,000.00	–	200,000.00
	–	–	-217,900.00	–	-217,900.00
	–	-15,416,301.70	-15,416,301.70	-5,600.79	-15,416,301.70
	272,207.59	-23,055,544.96	6,548,098.79	-274,585.08	6,273,513.71

Notes to the Consolidated Financial Statements

A. Company Data

Company name, domicile
aap Implantate AG, Berlin

Registered office
Lorenzweg 5, 12099 Berlin

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 listed on the regulated market since May 10, 1999 and traded in the Frankfurt Stock Exchange's Neuer Markt segment under Security ID number 506 660. On May 16, 2003, the Company was admitted to the market's Prime Standard segment, with further regulatory requirements.

Incorporation by modifying conversion

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

Type of business

aap Implantate AG is a medical sector enterprise. Its lines of business include 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 31 December 2003 in accordance with IFRS have been drawn up in conformity International Financial Reporting Standards (IFRS). These include the IFRS newly issued by the International Accounting Standards Board, the International Accounting Standards (IAS), and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC).

The consolidated financial statements comply with European Union Directive 83/349. In accordance with § 292 a of the German Commercial Code (Handelsgesetzbuch/HGB), these financial statements drawn up in accordance with IFRS have a discharging effect. The rules of German Accounting Standard 1 have been observed.

The consolidated financial statements of *aap* Implantate AG to December 31, 2003 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 HGB and the German Stock Corporation Act (Aktiengesetz). The transfer to IFRS rules was effected at the individual company level.

The consolidated balance sheet and the consolidated profit and loss statements are structured in accordance with IFRS regulations.

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

All amounts 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. It is broken down by payment flows resulting from business, investment and financing activity. The effects of exchange rate fluctuations are shown separately. The amount of liquid funds in the cash flow statement accords with the sum total of liquid funds in the balance sheet.

3. Segment reporting

The business activities of the *aap* Implantate Group in financial year 2003 did not extend to heterogeneous fields of business or 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	
	▶ 2003	▶ 2002
	HOLDING	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 Biomaterialien Vertriebs GmbH, Dieburg	100%	100%
aap Implants Inc., Plymouth, USA	90%	90%

2. Reporting date of the consolidated financial statements

Accordingly, the consolidated financial statements were prepared to December 31, 2003.

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.

For the sake of economic efficiency, all balance sheet items except for fixed assets were translated at the exchange rate on the reporting date. Fixed assets and depreciation were translated at historic rates.

Other expenses and income were translated 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 as used by the parent company.

5. Capital consolidation

Capital consolidation was effected by offsetting the book values of participations against the subsidiaries' equity capital at the time of acquisition, as revalued pro rata (IAS 22).

Where advisable, accrued differences were allocated 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. In the year under review, extraordinary amortization of goodwill that arose from the contribution of CORIMED Kundenorientierte Medizinprodukte GmbH and MEBIO Medizinische Biomaterialien Vertriebs-GmbH affected net earnings.

6. Debt consolidation

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

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 costs less planned depreciation. Goodwill from the individual financial statements is capitalized and, like the goodwill from capital consolidation, amortized in a straight line over a 15-year period.

Development costs are capitalized as intangible assets if a newly developed product or process can be clearly demarcated, is technically feasible and if the company plans to use it itself or to market it. Further prerequisites for capitalization are the likelihood of deriving future economic benefit and a reliable valuation of the asset.

Capitalized development costs include the cost of loan capital.

Capitalized development costs are depreciated 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. Research costs are recorded as expenses in the period in which they were incurred.

Fixed assets are valued at cost of acquisition or production and, where depreciable, taking into account planned depreciation. The production costs of tangible assets include the full costs.

Loan capital costs are not capitalized as part of acquisition or production costs.

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

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

Intangible assets and tangible fixed assets are depreciated extraordinarily if the sum obtainable for the asset is less than the book value. Assets are written up if and when there is no longer a reason for any previously undertaken extraordinary depreciation.

Financial assets are reported in the balance sheet at acquisition costs or at net book value. The shares of associated enterprises balanced by the equity accounting method are reported in the balance sheet at pro rata equity plus goodwill.

Lendings shown 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 and are calculated on the basis of standard activity.

In detail, production costs include in addition to directly attributable costs appropriate proportions of essential production overheads. These include material and manufacturing overheads and production-related administration 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.

Valuation is based on the FIFO method.

Inventory risks arising from diminished usability are taken account of by means of appropriate write-downs.

Lower values on the reporting date due to lower net losses on disposal are stated accordingly.

Long-term production orders are reported in the balance sheet using the percentage-of-completion method. The sum to be capitalized according to IAS 11 is shown under receivables and under sales revenues.

The stage of performance is determined according to expenses incurred and project phases that have been demonstrably completed.

Receivables 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 reported at cash value. Foreign-currency receivables are translated at the 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 down, with the resulting effect on earnings, in a straight line in accordance with the useful economic life of the assets they helped to acquire.

Stock options granted to employees and management were 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 was 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 provision required can be estimated reliably. Provisions are set at the settlement amount with the greatest likelihood of being determined.

Tax accruals are shown as arising from temporary differences in the IFRS 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 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 financial leasing agreements are reported as liabilities at the cash value of the leasing installments.

Foreign-currency liabilities are translated at the repayment exchange rate when the liability was incurred or at the higher selling rate on the balance-sheet date.

Accruals comprise outlay and income that are expenses and earnings after the reporting date as well as equity procurement costs.

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 liabilities 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 that results from applying the percentage-of-completion method. Customer discounts and rebates and returned goods are taken into account in the appropriate period in line with the sales revenues on which they are based.

In the case of some items, drawing up the consolidated financial statements involves the necessity to make estimates and assumptions that affect the assets, debts and contingent liabilities shown, as well as the valuation and level of income and expenditure shown. Actual amounts may diverge from these **estimated values**.

Based on talks and negotiations with investors that have been under way since mid-2003 and began taking concrete shape in April/May 2004 and the accompanying critical review of business strategy so far, the Management Board of *aap* developed a recovery concept. Accordingly, the strategic alignment of *aap* requires, in addition to implementation of reconstruction measures (strategic focus and re-capitalization) appropriate adjustments to balance-sheet values affecting expenditure. These are shown in the extraordinary result.

E. Special Notes in accordance with § 292 a HGB

The accounting, valuation and consolidation methods applied in accordance with IFRS differ substantially from German commercial law regulations in the following respects.

Intangible assets

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

Production costs

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

Long-term production orders

In the case of long-term production orders, HGB stipulates that as a matter of principle profit can only be realized after delivery and acceptance of the complete order. IFRS requires profit to be realized pro rata to the percentage of completion.

Inventories

In contrast with HGB, IFRS stipulates that only the sales market is to be taken into account for the lower valuation.

Tax accruals

HGB requires all tax accruals on temporary differences between trading balance sheet and tax balance sheet results to be ascertained in accordance with the timing concept. According to IFRS, tax accruals must be ascertained on all temporary differences between the amounts stated in the tax balance sheet and in the consolidated balance sheet. In contrast to HGB, tax accruals must also be shown for quasi-permanent differences and for losses carried forward for tax purposes.

Cost of procuring equity

IFRS states that the external costs of equity procurement, 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.

Provisions

IFRS states that provisions are to be made if the probability of a claim occurring is greater than 50%. Provisions are set at the fulfillment amount. In contrast, HGB requires provisions to be set at the level required on the balance sheet date according to sound business judgment.

F. Notes on the balance sheet

(1) Fixed assets

For movements in fixed assets, please see the consolidated schedule of assets attached as Annex 1. Accessions totaling € 1,699,000 in the financial year were allocated as self-made assets.

1. Intangible assets

Intangible assets acquired in return for payment are depreciated in a straight line pro rata to the historic cost of acquisition.

Useful economic life is as follows:

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

Book values of intangible assets that are given as security for liabilities amount to € 4,487,000.

2. Development costs

In the reporting period, development costs totaling € 1.339 million were capitalized. They include directly attributable loan capital costs of € 81,000 ascertained on the basis of the group's average financing costs of 8%. Development costs relate essentially to the following projects:

- Bone cement with antibiotic
- HF cement
- CS pellets - absorbable bone replacement
- Stable angle plates

In addition, research and further development costs totaling € 123,000 (previous year: € 242,000) were recorded as expenses.

Depreciation in the reporting period totaled € 1,117,000, of which € 726,000 was extraordinary depreciation (cf. G.17).

3. Tangible assets

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

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

Extraordinary depreciation totaling € 300,000 was undertaken on land and buildings in the reporting period.

The book value of leased tangible assets on December 31, 2003 amounted to € 907,000. The book values of tangible assets transferred by way of security or encumbered with land charges totaled € 1,423,000.

4. Financial assets

	2003		2002	
	T€	%	T€	%
Participating interests				
▪ OSARTIS GmbH & Co. KG, Obernburg	246	49.0	320	49.0
▪ GEOT Gesellschaft für Elektro-Osteo-Therapie mbH, München	38	30.0	62	30.0
▪ Cybernetic Vision AG Health Monitoring Technologies, Berlin	0	5.69	0	5.69
Other loans	**293**		**290**	
Total	**577**		**672**	

(2) Inventories

In order to state inventories at net sales value, in the year under review value adjustments totaling € 153,000 were made. In addition, the value of inventories was adjusted extraordinarily in the year under review by reductions of € 440,000 and € 844,000 (cf. G.17).

(3) Accounts receivable and other assets

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

The Other Assets item includes discounts totaling € 1,000 (previous year: € 4,000). The transaction costs capitalized in the previous years were treated as a deduction from equity.

	31.12.2003	OF WHICH DUE IN > 1 YEAR	31.12.2002	OF WHICH DUE IN > 1 YEAR
	T€	T€	T€	T€
Trade receivables	736	0	1,966	0
Receivable from associated companies	357	268	357	357
Other assets				
▪ Tax refund claims	102	0	15	0
▪ Warranty claims	1,747	0	2,299	578
▪ Other	237	35	1,241	737
	2,086	**35**	**3,555**	**1,315**
	3,179	**303**	**5,878**	**1,672**

(4) Deferred taxation

Tax accruals carried as assets totaling € 3,629,000 (previous year: € 1,416,000) include the following capitalized tax credit entitlements arising, according to the business plan, from the anticipated utilization of existing loss carryovers in the years ahead:

	2003	2002
	T€	T€
Corporate income tax, including solidarity surcharge	2,852	1,516
Trade tax	2,015	1,114
	4,867	2,630

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

Deferred tax credit claims totaling € 139,000 relate to items that are offset directly against equity. Deferred tax liabilities totaling € 2,096,000 result from 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 in accordance with IFRS.

Trade earnings tax was assessed on the basis of the annual result according to IFRS by adding trade tax paid and subtracting trade earnings. Trade tax is charged at roughly 17% after taking into account tax deductibility. Deferred corporate income tax 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 arising in connection with consolidation were ascertained on the basis of an group average tax rate of 39%.

(5) Equity

Capital stock

On December 31, 2003, the company's capital stock was € 4,869,529, divided into 4,869,529 individual bearer shares.

The Management Board with the Supervisory Board's approval decided on June 21, 2003 to increase the company's capital stock by € 105,264 from € 4,764,265 to € 4,869,529 by way of a capital increase from authorized capital by issuing 105,264 new bearer shares, each with an arithmetical share of € 1 in capital stock.

The issue price of the shares is 5% below the un-weighted average closing price of the company's shares in XETRA trading on the trading days from June 16 to June 20, 2003. New shares are entitled to profit from June 1, 2003.

Of the new shares, ruling out shareholders' subscription rights, 52,632 were acquired by Mr. Uwe Ahrens, Berlin, and 52,632 by BTVG Gesellschaft für Beteiligung & Vermögensverwaltung mbH, Berlin. They were entered in the companies' register on September 23, 2003.

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

Transaction costs

Transaction costs totaling € 218,000 were carried in the balance sheet as a deduction from equity.

Conditional capital

The General Meeting held on June 30, 2000 approved a conditional increase of up to € 380,000 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 by the issue of up to 96,000 individual bearer shares. New shares are entitled to profit from the start of the fiscal year in which 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 and senior executives of the company and of associated companies
- 25% to senior executives
- 57.9% to employees of the company and of associated companies

Stock options are 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 subscribe to shares 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 has increased by at least 20% on the price of issue and this price increase is greater than the percentage gain of the Frankfurt Stock Exchange Prime Pharma & Healthcare Performance Index during the same period.

The issue price corresponds to the average final trading price on the Frankfurt Stock Exchange over the 20 trading days prior to exercise, 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

	TRANCHE 2000
Number originally issued	256,727
Status as at Dec. 31, 2002	178,748
No. lapsed in 2003	0
Status as at Dec. 31, 2003	178,748

Stock subscription price: roughly € 15

The stock options run for a period of four years from the date of issue (December 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.

Authorised 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 the Annex.

(6) Current provisions

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

	STATUS AS AT 1.1.2003	TAKE-UP	RE-TRANSFER	TRANSFER	STATUS AS AT 31.12.2003
	T€	T€	T€	T€	T€
Tax provisions	19	18	0	24	25
Commitments to employees	140	140	0	112	112
Bonuses awarded	46	46	0	41	41
Commission	4	4	0	10	10
Licenses	79	37	6	70	106
Financial statement, audit costs	152	139	9	129	133
Employer's liability	28	26	2	32	32
Unpaid invoices	216	129	15	119	191
Share listing	300	0	50	0	250
Litigation costs and risks	18	15	3	765	765
Contingencies	0	0	0	200	200
Warranties	23	0	0	8	31
	1,025	**554**	**85**	**1,510**	**1,896**

(7) Liabilities

In agreements dated end of May 2004, the company's banks agreed that all loans will be redeemed for a total of approx. € 4.9 million so as to enable the company's recovery. Without taking these measures into account, the residual terms of liabilities, broken down by balance sheet heading, are as follows:

	31.12.2003 TOTAL	TIME TO MATURITY UP TO 1 YEAR	1-5 YEARS	MORE THAN 5 YEARS	PREVIOUS YEAR
	T€	T€	T€	T€	T€
Amounts owed to banks	10,549	4,757	5,523	269	10,841
Prepayments received on orders	488	488	0	0	177
Trade receivables	2,276	2,276	0	0	1,860
Liabilities to associated companies	10	10	0	0	10
Other liabilities	4,838	3,274	1,564	0	5,480
of which					
▪ financial leasing	(290)	(221)	(69)	0	0
▪ social security-related	(149)	(149)	0	0	0
▪ taxes	(201)	(201)	0	0	0
	18,161	**10,805**	**7,087**	**269**	**18,368**

Of the amounts owed to banks, € 7,574,000 is secured by land charges and assignments of machines and inventories, by assignment of accounts receivable and by pledging patent rights, and € 2,975,000 is secured by assignment of receivables and by assignments of a license/patent pool. These liabilities totaling € 2,975,000 are further secured by absolute guaranties in the sum of € 781,000 provided by partners and contributing partners of the MEBIO/CORIPHARM Group.

Of long-term liabilities (time to maturity > 1 year) totaling € 7,356,000, € 7,296,000 (previous year: € 5,491,000) was subject to interest. The average interest charge was around 6.8% (previous year: 7.4%).

G. Notes on the Profit and Loss Statement

(8) Sales revenues

	2003	2002
	T€	T€
By region		
▪ Germany	8,411	9,206
▪ Asia	822	2,416
▪ Africa	38	27
▪ North and South America	857	771
▪ Europe	832	909
Total	**10,960**	**13,329**
By segment		
▪ Endoprosthetics	5,953	5,936
▪ Osteosynthesis	4,848	7,052
▪ Orthobiology	159	119
▪ R & D services	0	222
Group total as per IAS	**10,960**	**13,329**

(9) Other operating income

	2003	2002
	T€	T€
Private car use	60	61
Income from re-transfer of provisions	86	46
Income from write-back of special item for investment allowances and premiums	35	164
Contract penalties	0	137
Income from expense allowances	28	0
Income from the disposal of current assets	69	0
Insurance claims	8	31
Income form reduction in individual value adjustment of receivables	28	5
Other	239	239
Total	**553**	**683**

(10) Personnel expenses

	2003	2002
	T€	T€
Wages and salaries	3,264	4,187
▪ of which stock options issued	0	(597)
Social insurance contributions and expenses for old-age provision and for support	605	653
Total	**3,869**	**4,840**

Average payroll during the year

	2003	2002
Wage earners	51	50
Salary earners	51	59
Total	**102**	**109**

(11) Depreciation

Scheduled depreciation of tangible assets totaled € 1,263,000 (previous year: € 1,039,000) and of intangible assets € 1,948,000 (previous year: €1,841,000); of this, € 264,000 (previous year € 264,000) was amortization of goodwill resulting from capital consolidation.

Extraordinary depreciation of € 300,000 relates to land and buildings. Extraordinary depreciation totaling € 10,392,000 is shown in the extraordinary result (cf. G.17).

(12) Other operating expenses

	2003	2002
	T€	T€
Advertising and travel costs	570	661
Cost of premises	729	721
Consulting fees	960	537
Leasing	137	123
Office requisites, telephone, fax, postage	156	181
Freight charges, packaging material, cost of delivery	690	476
Vehicle goods	134	154
Repairs and maintenance	106	99
Insurances, subscriptions, fiscal/public charges	204	185
Losses and value reductions arising from accounts receivable	57	261
Third-party services	201	196
Patent fees, other fees	0	300
Share listing costs	56	173
Development costs	765	0
Currency differences	237	82
Other costs	477	993
Total	**5,479**	**5,142**

(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-Osteotherapie mbH, totaling minus € 55,000 (previous year: minus € 90,000), and amortization of € 44,000 (previous year: € 44,000) on the goodwill acquired.

(14) Financial result

	2003	2002
	T€	T€
Income from other lendings	17	23
Other interest and similar income	27	26
Other interest and similar expenditure		
▪ Interest on long-term debts to banks	-593	-672
▪ Interest on current debts to banks	-331	-316
▪ Interest of sleeping partners	-164	-180
▪ Write-back of financing costs	-29	-52
▪ Other interest expenditure	-50	-84
	-1,167	**-1,304**
Total	**-1,123**	**-1,255**

(15) Exchange rate differences

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

	2003	2002
	T€	T€
Income from exchange rate differences	19	5
Cost of exchange rate differences	-237	-82
Total	**-218**	**-77**

(16) Income and expenditure unrelated to the accounting period

In fiscal 2003, there was no income or expenditure unrelated to the accounting period that was important for assessing the earnings situation.

(17) Extraordinary expenses

Based on talks and negotiations with investors that have been under way since mid-2003 and began taking concrete shape in April/May 2004 and the accompanying critical review of business strategy so far, the Management Board of *aap* developed a recovery concept. Accordingly, the strategic alignment of *aap* requires, in addition to implementation of reconstruction measures (strategic focus and re-capitalization) appropriate adjustments to balance-sheet values affecting expenditure. This led to depreciation totaling € 11,236,000, broken down by balance-sheet item as follows:

	T€
Rights and licenses	6.567
Goodwill	3.099
Capitalized development services	726
Inventories	844
	11,236

(18) Taxes on earnings

Earnings tax costs as per IFRS (cf. Tz 6) can be translated to the theoretical tax expense as follows. This is based on a tax rate of 39% (previous year: 39%), comprising German corporate income tax plus solidarity surcharge, and trade tax.

	2003	2002
	T€	T€
Pre-tax earnings	-17,472	-3,332
Theoretical tax expense 39% (previous year: 39%)	-6,815	-1,299
Tax effects		
▪ Depreciation of goodwill resulting from capital consolidation and companies balances by the equity method	1,328	120
▪ Permanent differences	2,491	0
▪ Write back of deferred tax credits resulting from adjustment of loss carryovers	887	2,346
▪ Non-tax-deductible expenses and additions to trade tax	73	52
▪ Results of associated companies	29	0
▪ Tax-free income	-43	-31
Total adjustments	4,765	2,487
Earnings tax expense according to IFRS	-2,050	1,188
Effective tax rate in %	12%	36 %

(19) Earnings per share in accordance with IAS 33

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

	2003	2002
Period result	T€ -15,422	T€ -4,429
Number of shares (in '000s)	4,817	4,764
Earnings per share	€ -3.20	€ -0.93

Diluted earnings per share take into account the weighted average potential number of shares as a result of the 178,748 stock options issued on December 1, 2000 that were still valid.

	2003	2002
Result for the period	T€ -15,422	T€ -4,429
Diluted number of shares ('000s)	4,996	4,943
Earnings per share	€ -3.09	€ -0.90

H. Other information

(20) Cash flow statement

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

	2003	2002
	T€	T€
Interest income	12	23
Interest expenses	962	842

Earnings tax paid amounts to € 0 (previous year: € 6,000)

(21) Participating interests

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

	NAME	DOMICILE	PARTICIPATION	EQUITY	RESULT
			%	T€	T€
1.	*aap* Implants Inc.	USA, Massachusetts	90	-1,957	-56
2.	CORIMED Kundenorientierte Medizinprodukte GmbH	Dieburg	100	-141	-36
3.	CORIPHARM Medizinprodukte Verwaltungs-GmbH	Dieburg	100	33	2
4.	CORIPHARM Medizinprodukte GmbH & Co. KG	Dieburg	100	-1,273	-93
5.	MEBIO med. Biomaterial Vertriebs GmbH	Dieburg	100	57	88

This information relates to financial statements in accordance with IFRS.

II. Associated enterprises

This information relates to the financial statement to December 31, 2003 in accordance with IFRS.

	NAME	DOMICILE	PARTICIPATION	EQUITY	RESULT
			%	T€	T€
6.	OSARTIS GmbH & Co. KG	Aschaffenburg	49	-742	-88

	NAME	DOMICILE	PARTICIPATION	EQUITY	RESULT
		%	T€	T€	
7.	OSARTIS Verwaltungs GmbH	Aschaffenburg	49	-	-
8	GEOT Gesellschaft für Elektro-Osteo-Therapie mbH	München	30	-321	-242

This information relates to financial statements to December 31, 2002 drawn up in accordance with German commercial law.

III. Shareholdings

	NAME	DOMICILE	PARTICIPATION	EQUITY	RESULT
			%	T€	T€
9.	Cybernetic Vision Health AG Monitoring Technologies	Berlin	5.96	-	-

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

(22) 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.

(23) Other financial commitments

Other financial commitments as defined by § 285 No. 3 HGB arise from rental agreements totaling € 1,640,000, of which € 589,000 falls due within one year, while € 1,032,000 is payable within two to five years and € 19,000 in more than five years.

By contractual agreement, the purchase price for the holding in GEOT Gesellschaft für Elektro-Osteotherapie 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	Cash value	Operational leasing Nominal value
	T€	T€	T€
Payable within 1 year	221	221	129
Payable in 1 to 5 years	69	64	119
Payable after more than 5 years	0	0	0
	290	285	248

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.

(24) Related enterprises and persons

Related enterprises consist of OSARTIS GmbH & Co. KG and GEOT as associated enterprises. During fiscal year 2003 business with them resulted in the following balance-sheet items:

	OSARTIS KG	GEOT
	T€	T€
Trade receivables	0	9
Other assets	0	15
Loans	**357**	**0**
Revenues	**0**	**8**
Accounts payable for goods and services	-27	0
Cost of materials	**-84**	**0**

Mr. Uwe Ahrens in 2000 loaned the reporting company a total of € 2,556,000 to finance the acquisition of shares in the MEBIO-CORIPHARM Group. Interest incurred in the financial year totaled € 35,000. The loans run until May 30, 2006 and they were not repaid in 2003. The balance on December 31, 2003 was € 753,000. Interest is payable at the 3-month Euribor rate.

(25) Management Board, Supervisory Board

Members 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 € 307,961.94.

The members of the board received 78,182 stock options.

The members of the Management Board hold the following supervisory board directorships:

Mr. Uwe Ahrens:
STM Medizintechnik GmbH
bmp AG Venture Capital & Network Management, Berlin
mediport Venture GmbH (until July 31, 2003)
HJS Gelenksysteme GmbH
Celon AG (until August 31, 2003)

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 (until June 24, 2003)**
- **Prof. Dr. Friedrich-Leopold Freiherr von Stechow, businessman, Berlin**
- **Dr. Heinz Helge Schauwecker, senior medical consultant and university teacher, Berlin**
- **Prof. Dr. Dr. Reinhard Schnettler, university professor, Gießen (from June 24, 2003)**

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 2007.

The General Meeting held on June 24, 2002 resolved to elect Prof. Dr. Dr. Reinhard Schnettler to replace Prof. Dr. Dr. h.c. Horst Cotta 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 2007.

Supervisory Board remuneration totaled € 72,219.94 in the financial year. This was not paid out.

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. Prof. Dr. Friedrich-Leopold Freiherr von Stechow:
Ev. Kreditgenossenschaft eG
- Chairman -
Düsseldorfer Hypothekenbank
Deutsche Rettungsflugwacht e.V.
Fürstlich Castell'sche Bank, Würzburg
SMC GmbH & Co. KG

The members of the Supervisory Board and the Management Board held the following shares:

	Shares		Options	
	▶ 2003	▶ 2002	▶ 2003	▶ 2002
Supervisory Board				
▪ Lothar Just	0	0	0	0
▪ Klaus Kosakowski	3,000	3,000	0	0
▪ Prof. Dr. Dr. Reinhard Schnettler	28,094	28,094	0	0
▪ Dr. Heinz Helge Schauwecker	0	2,966	0	0
▪ Dieter Borrmann	0	0	0	0
▪ Prof. Dr. Friedrich-Leopold Freiherr v. Stechow	0	0	0	0
▪ Prof. Dr. Dr. h. c. Horst Cotta	10,000	10,000	0	0
Management Board				
▪ Uwe Ahrens	1,358,436	1,298,603	44,676	44,676
▪ Bruke Seyoum Alemu	11,520	1,000	33,506	33,506

(26) 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

(27) Publication

The company's Management Board on May 28, 2004 approved these consolidated financial statements to December 31, 2003 for publication.

(28) Events after the balance sheet date

In an agreement dated May 28, 2004, a number of investors undertook to subscribe to a capital increase of € 8,000,000. In further agreements dated end of May 2004, the company's banks agreed that all loans will be redeemed for a total of approx. € 4.9 million so as to enable the company's recovery.

On February 20, 2004, it was agreed to merge MEBIO Medizinische Biomaterialien Vertriebs-GmbH and CORIMED Kundenorientierte Medizinprodukte GmbH with effect from July 1, 2003. This was recorded in the register of companies on March 2, 2004.

HJS Gelenk-System GmbH on March 17, 2004 terminated extraordinarily the license agreement to sell a knee implant. *aap* Implantate AG is disputing the effectiveness of this termination and has initiated legal action.

Berlin, May 28, 2004

The Management Board

Dipl.-Ing. Uwe Ahrens

Dipl.-Ing. Bruke Seyoum Alemu

Auditor's Certification

▶ We have audited the consolidated financial statements drawn up by *aap* Implantate Aktiengesellschaft, comprising balance sheet, profit and loss statement, statement of changes in equity, cash flow statement and notes, for the financial year from January 1, 2003 to December 31, 2003. The drawing up and content of the financial statements in accordance with the IASB International Financial Reporting Standards (IFRS) is the responsibility of the management board of *aap* Implantate Aktiengesellschaft. Our task is to assess, on the basis of our audit, whether the consolidated financial statements accord with IFRS.

We carried out our audit of the consolidated financial statements in accordance with German audit regulations and observing the German principles of proper auditing laid down by the Institute of Auditors (Institut der Wirtschaftsprüfer/IDW). These state that the audit is to be planned and executed in such a way as to be able to judge with sufficient certainty whether the consolidated financial statements are free from material misstatements. In determining the audit activities, knowledge of the group's business activities and about its economic and legal environment is taken into account, as are expectations of possible errors. As part of the audit, evidence for the amounts stated and for information given in the consolidated financial statements is assessed on the basis of random checks.

The audit includes an evaluation of the accounting principles applied and of the fundamental estimates made by the management board, as well as forming an opinion of the overall picture presented in the consolidated financial statements. We are of the opinion that our audit forms a sufficiently sound basis for our judgment.

In our considered opinion, the consolidated financial statements in accordance with IFRS convey a picture of the group's asset, financial and earnings position and of payment flows during the financial year that accurately reflects the actual situation.

Our audit, which also covered the report on the situation of the company and the group drawn up by the management board for the financial year from January 1, 2003 to December 31, 2003, led to no objections. It is our conviction that the report on the situation of the company and the group, together with the other information in the consolidated financial statements, overall give an accurate idea of the group's situation and accurately describe the risks of future development.

We also certify that the consolidated financial statements and the report on the situation of the *aap* Implantate Aktiengesellschaft company and group for the financial year from January 1, 2003 to December 31, 2003 fulfill the prerequisites for the company to be exempted from drawing up consolidated financial statements and a report on the situation of the company and the group in accordance with German law.

Without qualifying this assessment, we draw attention to the statements made in the report about the situation of the company and the group. In the section headed Risks inherent in future corporate developments, it is pointed out that the equity injection of € 8.0 million guaranteed by investors on the basis of the agreement dated May 28, 2004 is subject to the condition precedent that a corresponding capital increase resolution is entered in the register of companies and that the Federal Office for Financial Services (BAFin) exempts investors from a compulsory offer as laid down in § 37 of the German Securities Acquisition and Takeover Act (WpÜG).

Berlin, May 28, 2004

Dr. Röver & Partner KG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Helmut Schuhmann
Auditor

Bettina Grothe
Auditor

Annual Financial Statement of *aap* Implantate AG

Balance Sheet

ASSETS	(NOTES)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
▶ **A Fixed assets**	**(3)**		
I. Intangible assets			
1. Industrial property rights and similar rights and values, and licenses thereto		867,597.32	2,031
2. Goodwill		1.00	0
		867,598.32	**(2,031)**
II. Tangible assets			
1. Land and leasehold rights and buildings, including builds on third-party land		507,352.00	815
2. Plant and machinery		1,440,238.45	1,671
3. Other fixtures and fittings tools and equipment		595,892.21	620
		2,543,482.66	**(3,106)**
III. Financial assets			
1. Shares in affiliated undertakings		895,966.95	896
2. Loans to affiliated undertakings		2,730,722.06	2,586
3. Investments	(15)	206,812.59	291
4. Other loans		293,362.91	290
		4,126,864.51	**(4,063)**
▶ **B Current assets**			
I. Inventories			
1. Raw materials and supplies		622,527.35	845
2. Work in progress		935,781.00	966
3. Finished goods and goods for resale		4,430,660.01	5,483
		5,988,968.36	**(7,294)**
II. Accounts receivable and other assets	(5)		
1. Accounts receivable		405,804.24	1,640
2. Due from affiliated companies	(5)	777,960.24	607
3. Other assets		1,850,842.02	3,490
		3,034,606.50	**(5,737)**
III. Checks, cash on hand and on deposit with Deutsche Bundesbank, postal giro balances, in other banking accounts		76,773.19	685
▶ **C Prepayments and accrued income**	**(6)**	**38,278.76**	**70**
Total assets		**16,676,572.30**	**22,986**

T€ corresponds to € 1,000

EQUITY AND LIABILITIES	(NOTES)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
▶ **A Capital stock**	**(7)**		
I. Subscribed capital		4,869,529.00	4,764
II. Capital reserve		10,849,121.03	10,754
III. Revenue reserve			
1. Legal reserve		41,703.95	42
2. Other revenue reserves		218,889.59	219
		260,593.54	
IV. Net loss for the year		-12,114,051.32	-5,309
		3,865,192.25	**(10,470)**
▶ **B Special item for investment grants toward fixed assets**		**256,921.26**	**319**
▶ **C Provisions**			
1. Provisions for taxation		0.00	18
2. Other provisions	(8)	1,716,790.00	844
		1,716,790.00	**(862)**
▶ **D Liabilities**			
1. Due to banks		7,379,987.24	7,806
2. Advances from customers		147,960.37	0
3. Accounts payable		1,244,714.31	976
4. Due to affiliated companies		215,183.77	11
5. Due to undertakings with which the company is linked by virtue of participating interests		9,914.72	10
6. Other liabilities		1,839,917.38	2,532
thereof taxes: € 64,308.29 (previous year: € 492,149.92)			
thereof social security: € 100,503.24 (previous year: € 162,540.74)			
		10,837,668.79	**(11,335)**
Total Equity and Liabilities		**16,676,572.30**	**22,986**

T€ corresponds to € 1,000

Liabilities arising from contingencies € 1,305,817.22 (previous year: € 1,237,951.07)

thereof due to affiliated companies € 450,000.00 (previous year: € 382,133.85)

Income Statement

	(NOTE)	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
		€	T€
1. Sales revenues	**(10)**	5,484,799.00	10,783
2. Decrease in finished goods inventories and work in process		-239,172.77	-282
3. Capitalized cost of self-constructed assets		391,731.10	436
4. Total operating performance		5,637,357.33	10,937
5. Other operating income	(13)	731,328.44	931
6. Cost of materials			
a) Cost of raw materials, consumables and supplies, and of purchased materials		-1,136,606.60	-1,456
b) Cost of purchased services		-102,790.80	-294
		-1,239,397.40	**-(1,750)**
7. Personnel expenses	(13)		
a) Wages and salaries		-2,367,868.54	-3,213
b) Social security and other pension costs		-447,873.89	-478
		-2,815,742.43	**-(3,691)**
8. Depreciation			
a) of intangible fixed assets and tangible assets, and capitalized start-up and business expansion expenses		-1,388,696.68	-967
thereof extraordinary depreciation as per § 253 (2) S.3 HGB € 300,000.00			
b) of current assets to the extent that it exceeds normal company depreciation		-853,100.13	-832
9. Other operating expenses	(11)	-4,302,057.14	-4,139

T€ corresponds to € 1,000

Continuation (NOTE)	▶ 1.1.-31.12.2003 €	▶ 1.1.-31.12.2003 T€
10. Investment income	186,781.64	188
11. Other interest and similar income thereof from affiliated companies: € 0.00 (previous year: € 2,958.28)	27,603.87	28
12. Amortization of financial assets and investments classified as current assets	-84,065.08	0
13. Other interest and similar expenses	-681,492.94	-834
14. Result of ordinary business activities	**-4,781,480.52**	**-129**
15. Extraordinary expenses	-2,023,046.66	0
16. Extraordinary result	-2,023,046.66	0
17. Taxes on income	-7.44	8
18. Other taxes	-705.72	-1
19. Net loss for the year	-6,805,240.34	-122
20. Loss carryover	-5,308,810.98	-5,187
21. Balance sheet loss	**-12,114,051.32**	**-5,309**

T€ corresponds to € 1,000

Notes on the Financial Statements

(1) General

The financial statements to December 31, 2003 were drawn up as required by the German Commercial Code (Handelsgesetzbuch/HGB).

The general regulations laid down in § 238 to § 263 for all businesses and the supplementary regulations for stock corporations in § 264 ff. were observed.

The income statement was drawn up on the basis of the total costs method.

The balance sheet and income statement are broken down as specified in § 266 and § 275 HGB.

(2) Accounting and valuation methods

Intangible assets acquired for cash are stated at cost of acquisition and depreciated according to schedule.

Tangible fixed assets are valued at cost of acquisition or manufacture and, insofar as they are depreciable, are valued taking scheduled depreciation into account.

Capitalized goods and services for own account were valued at cost of manufacture, the cost of manufacture corresponding to the valuation of the finished products.

Non real estate fixed assets are depreciated in a straight line over the shortest period permitted for tax purposes, with first-half accruals being depreciated at the full annual rate and assets acquired in the second half being depreciation at half the annual rate. Fixed assets costing less than € 410 are written off in full in the year of acquisition in accordance with § 6 Par. 2 of the German Income Tax Act (EStG). Retirements are undertaken at the cost of acquisition less accumulated depreciation at the time of retirement.

Shareholdings in associated companies and **participations** are stated at cost of acquisition or at any lesser value applicable. Interest-bearing loans are reported at their nominal value.

Inventories are valued at either the cost of acquisition or manufacture or at their value on the balance sheet date. Raw materials and supplies are valued at the cost of acquisition in strict accordance with the lowest value principle in compliance with § 253 Par. 3 HGB.

Unfinished and finished products and unfinished services are valued at cost of production. This includes individual that must in accordance with § 255 Par. 2 Clause 2 HGB be capitalized and an appropriate share of material and overhead costs as per § 255 Par. 2 Clause 3 HGB and of the depreciation in value of fixed assets insofar as it is due to manufacture. General administrative costs are included in manufacturing costs in accordance with § 255 Par. 2 Clause 4 HGB. Interest paid on capital from outside sources is not taken into account. In keeping with the lowest value principle as laid down in § 253 Par. 3 HGB, deductions were made to take limited usability into account.

Accounts receivable and other assets are stated at their nominal value or at their lower reporting date value as per § 253, Par. 3 Clause 2 HGB. Non interest bearing claims with over a year to maturity are stated at their cash value. A flat rate reduction amounting to 3% of accounts receivable for which individual adjustments have not been made is undertaken to cover the general credit risk. Investment allowances are carried as liabilities under the heading **Special items for investment allowances**. They are written off, with the resulting effect on earnings, in a straight line in accordance with the usual 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) as personnel expenditure on the one hand and as a contribution toward capital reserves as per § 272 Par. 2 Clause 2 HGB on the other. Transfer to capital reserves is undertaken over the two-year lockup period agreed. Stock options were valued at the time of issue on the basis of the Black-Scholes option price model.

In creating **reserves**, due regard was paid to recognizable risks and reported liabilities. They are assessed at the level necessitated by commercial prudence.

Liabilities are stated at the sum that is due for repayment. Liabilities in foreign currency were converted either at the repayment rate when the liability was incurred or at the settlement rate on the balance sheet date, if that was higher.

Contingent liabilities are possible or existing obligations based on past events that are unlikely to lead to an outflow of resources. They are not listed in the balance sheet. The stated volume of contingent liability commitments corresponds to the extent of liability existing on the balance sheet date.

The Management Board of *aap* has developed a reconstruction concept based on discussions and negotiations held with investors since mid-2003 that took concrete shape in April/May 2004 and on the accompanying critical review of previous business strategy. The company's strategic realignment accordingly requires, along with the implementation of reconstruction measures (strategic focusing and recapitalization) appropriate adjustments to balance sheet values with an affect on expenditure that are stated in the extraordinary result.

Notes on the Balance Sheet and Income Statement

(3) Expenditure on expansion of business activity and fixed assets

For developments in fixed assets in fiscal 2003, please see the attached fixed-asset movement schedule.

(4) Financial assets

The shares in CORIPHARM Medizinprodukte GmbH & Co. KG, CORIPHARM Medizinprodukte Verwaltungs-GmbH, CORIMED Kundenorientierte Medizinprodukte GmbH, OSARTIS GmbH & Co. KG and OSARTIS Verwaltungs-GmbH acquired on October 1, 2000 were reported at the nominal value of the *aap* Implantate AG shares issued to the contributors plus the cash payment made. Acquisition costs were reduced by a contractual purchase price reduction due to breaches of warranty. The € 84,000 shareholding in GEOT Gesellschaft für Elektro-Osteo-Therapie mbH was written off in the course of the year under review.

(5) Current assets

Extraordinary inventory value adjustments totaling € 440,000 and € 844,000 were made in the reporting year by way of marketability writedowns.

Accounts receivable from associated companies consist of receivables arising from day-today business transactions.

Other assets include a claim arising from breaches of warranty against the contributors of shareholdings in CORIPHARM Medizinprodukte GmbH & Co. KG, CORIPHARM Medizinprodukte Verwaltungs-GmbH and CORIMED Kundenorientierte Medizinprodukte GmbH amounting to € 1.747 million.

Accounts receivable and other assets include € 35,000 with more than a year to maturity.

(6) Accruals and deferrals

Discounts totaling € 1,000 are listed.

(7) Equity capital

The company's **capital stock** on December 31, 2003 totaled € 4,869,529 and consisted of 4,869,529 individual bearer shares.

The Management Board decided on June 21, 2003, with the Supervisory Board's approval, to increase the company's capital stock by means of a capital increase from approved capital by € 105,264 to € 4,869,529 from the present € 4,764,265 by issuing 105,264 new bearer shares, each with a nominal share of € 1.00 in the capital stock.

The issue price for the new shares was 5% below the unweighted average of Xetra closing prices for the company's share on the trading days between June 16 and June 20, 2003. The new shares were entitled to a share in the company's profits from June 1, 2003.

Ruling out a rights issue to shareholders, 52,632 of the new shares were acquired by Mr. Uwe Ahrens, Berlin, and 52,632 by BTVG Gesellschaft für Beteiligung & Vermögensverwaltung mbH, Berlin. They were entered into the commercial register on September 23, 2003.

The **statutory reserve** at the end of fiscal 2003 totaled € 41,703.95 and, jointly with the capital reserve, amounted to more than one tenth of the capital stock.

Authorized but unissued capital

The June 30, 2000 shareholders' meeting authorized a conditional increase in equity capital of up to € 380,000 by the issue of up to 380,000 bearer share certificates. The May 29, 2001 shareholders' meeting authorized a further conditional capital increase of € 96,000 by the issue of up to 96,000 bearer share certificates. The new shares are entitled to profits from the start of the financial year in which they are issued.

The conditional capital increase serves the sole purpose of granting stock options to employees and members of the management of the company or of an associated company as follows:

2000

- 42.1% to members of the Management Board and the management of the company and associated companies
- 57.9% to employees of the company and associated companies

2001

- 17.1% to members of the Management Board of the company and associated companies
- 25% to members of the management
- 57.9% to employees of the company and associated companies

Stock options will be issued as stipulated in the relevant provisions of the 2000 and 2001 stock option plans.

Under the 2000 stock option plan, 256,727 option rights were agreed. Options may only be exercised after a two-year lockup period provided that the average closing price for the company's shares on the Frankfurt stock exchange has risen by at least 20% during the previous 20 trading days and that the price increase exceeded the percentage increase of the Frankfurt stock exchange's Prime Pharma & Healthcare Performance Index over the same period.

The issue price is the average closing price on the Frankfurt stock market during the 20 trading days before the option rights issue, but at least the lowest issue price as per § 9, Par. 1 of the German Stock Corporation Act (AktG).

Stock options

	Tranche 2000
Number originally issued	256,727
Status as at Dec. 31, 2002	178,748
Expired during 2003	0
Status as at Dec. 31, 2003	178,748
Option price approx. € 15	

The option rights are valid for a four-year term from the date of issue (December 1, 2000).

Granting of subscription rights is limited to four exercise periods per year. Each lasts three weeks beginning on the day after publication of the quarterly reports or of the annual financial statement.

Approved capital

The Management Board is authorized, with the approval of the Supervisory Board, to increase by March 31, 2005 the company's equity capital once or more by up to a total of € 2,380,000 against payment in cash or kind and to issue stock as it sees fit.

It may rule out an rights issue to existing shareholders

a) to offset residual amounts,
b) to issue employee shares to company staff,
c) to acquire holdings in companies or of companies or parts of companies in return for shares in the company,
d) if a capital increase against cash does not exceed 10% of equity capital and the issue price of the shares is not substantially lower than the market price,
e) to cover the cost of acquiring capital and of payment for services.

Please see the attached schedule of equity capital development.

(8) Provisions

Movements of other provisions in the financial year were as follows:

	STATUS AS AT Jan. 1, 2003 €	TAKE-UP €	RETRANSFER €	TRANSFER €	STATUS AS AT Dec. 31, 2003 €
Commitments to employees	128,000.00	128,000.00	0.00	102,000.00	102,000.00
Bonus and commission commitments	49,900.00	49,766.94	133.06	51,000.00	51,000.00
Unpaid invoices	251,000.00	136,854.33	8,195.67	142,840.00	248,790.00
Annual financial statement and audit costs	115,000.00	108,857.34	6,142.66	100,000.00	100,000.00
Provision for impending losses	0.00	0.00	0.00	200,000.00	200,000.00
Costs and risks of legal action	0,00	0.00	0.00	765,000.00	765,000.00
Share issue	300,000.00	0.00	50,000.00	0.00	250,000.00
	843,900.00	**423,478.61**	**64,471.39**	**1,360,840.00**	**1,716,790.00**

(9) Liabilities

In agreements signed at the end of May 2004, the company's banks agreed to write off all loan claims against the company in return for a total of approx. € 4.9 million to facilitate the company's reconstruction. Time to maturity of liabilities, broken down by balance sheet heading, can be seen in Schedule of Liabilities but does not include this latest move.

(10) Sales revenues

Sales revenues, broken down by region, are as follows:

	2003 T€	2002 T€
Germany	4,115	7,734
Other European Union countries	460	466
Other foreign countries	1,025	2,715
Sales revenue deductions	-115	-132
	5,485	**10,783**

(11) Depreciation of current assets

Depreciation of current assets, insofar as it exceeds the company's customary depreciation (€ 853,000), relates to a € 67,000 loan to *aap* Implants Inc. and a € 786,000 loan to Mr. Walther.

(12) Breakdown of employees by category:

	2003	2002
Average number of staff employed:	80	84
thereof		
•Wage earners	49	48
•Salary earners	31	36
•Full-time	70	72
•Part-time	7	8
•Temporary	3	4
	80	**84**
•Administration	15	15
•Sales	13	16
•Production	49	50
•Development	3	3
	80	**84**

(13) Earnings and expenditure unrelated to the accounting period

In the year under review, expenditure unrelated to the accounting period totaling € 164,000 occurred, mainly (€ 93,000) as a result of issuing credit notes to OMC Inc. for backhauling goods deliveries.

(14) Extraordinary expenditure

Based on the course of business in 2003 and on discussions and negotiations with investors held since mid-2003 that took concrete shape from mid-April 2004 and on the resulting critical review of the company's previous business strategy, the Management Board of *aap* has drawn up a reconstruction concept. The company's strategic realignment accordingly calls for balance sheet value adjustments in addition to implementation of the reconstruction measures (strategic focusing and recapitalization). This has led to writedowns totaling € 1.651 million as follows:

	T€
Rights and licenses	807
Inventories	844
	1,651

Other extraordinary expenditure totaling € 372,000 resulted from composition settlements agreed in the course of the financial year.

Other Information

(15) Participations

I. Affiliated companies as per § 271 Par. 2 HGB

	NAME	DOMICILE	SHAREHOLDING	EQUITY	RESULT
			%	T€	T€
1.	*aap* Implants Inc.	USA, Massachusetts	90	-1,957	-56
2.	CORIMED Kundenorientierte Medizinprodukte GmbH	Dieburg	100	-164	-58
3.	CORIPHARM Medizinprodukte Verwaltungs-GmbH	Dieburg	100	33	2
4.	CORIPHARM Medizinprodukte GmbH & Co. KG	Dieburg	100	-6,568	-390
5.	MEBIO med. Biomaterial Vertriebs GmbH	Dieburg	100	57	88

II. Associated companies

	NAME	DOMICILE	SHAREHOLDING	EQUITY	RESULT
			%	T€	T€
6.	OSARTIS GmbH & Co. KG	Aschaffenburg	49	-1,889	-195
7.	OSARTIS Verwaltungs-GmbH	Aschaffenburg	49	-	-
8	GEOT Gesellschaft für Elektro-Osteo-Therapie mbH	München	30	-	-

Annual financial statements to December 31, 2003 were either not available or only available in draft form.

III. Shareholdings

	NAME	DOMICILE	SHAREHOLDING	EQUITY	RESULT
			%	T€	T€
9.	Cybernetic Vision AG Health Monitoring Technologies	Berlin	5.96	-	-

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

(16) Guaranty commitments

By the terms of the November 7, 2000 agreement on the contribution of capital and the supplementary agreement dated May 4, 2001, *aap* Implantate AG undertook to replace with other collateral by June 30, 2001 € 856,000 in guaranty commitments to third parties made by shareholders in the companies acquired in respect of liabilities incurred by the said companies. The reporting company issued a guaranty for Landesbank Hessen-Thüringen loans to CORIPHARM Medizinprodukte GmbH & Co. KG, CORIPHARM Medizinprodukte Verwaltungs-GmbH, MEBIO Medizinische Biomaterialien Vertriebs-GmbH and CORIMED Kundenorientierte Medizinprodukte GmbH. These loans totaled € 450,000 as of December 31, 2003.

(17) Other financial commitments

Other financial commitments as per § 285 No. 3 HGB arise from rental agreements totaling € 1.035 million of which € 365,000 is due within one year and the remaining € 670,000 is due within 2 to 5 years.

Leasing agreements account for other financial commitments totaling € 132,000 of which € 85,000 is due in 2004 and € 47,000 is due in 2005.

By contractual agreement, the purchase price for the shareholding in GEOT Gesellschaft für Elektro-Osteo-Therapie mbH will increase from € 184,000 by 15% of the sum by which the company's value 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 liability of between € 0 and € 491,000 in connection with the acquisition.

(18) Management Board, Supervisory Board

Members 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,

Their combined remuneration amounted to € 307,961.94.

The company took out D&O insurance cover for the management. 2003 premiums totaled € 24,840.

Members of the Management Board were granted 78,182 stock options.

Management Board members hold the following supervisory board directorships:

Mr. Uwe Ahrens:
STM Medizintechnik GmbH
bmp AG Venture Capital & Network Management, Berlin
mediport Venture GmbH (until July 31, 2003)
HJS Gelenk-System GmbH
Celon AG (until August 31, 2003)

Members of the company's **Supervisory Board** in the year under review were:

- **Mr. Lothar Just,** auditor and tax accountant, Berlin (chairman)
- **Mr. Klaus Kosakowski,** Dipl. Volkswirt, Berlin (vice-chairman)
- **Mr. Dieter Borrmann,** Dipl. Ingenieur, Berlin
- **Prof. Dr. Dr. h.c. Horst Cotta,** Heidelberg (until June 24, 2003)
- **Prof. Dr. Friedrich-Leopold Freiherr von Stechow,** businessman, Berlin
- **Dr. Heinz Helge Schauwecker,** hospital director and university lecturer, Berlin
- **Prof. Dr. Dr. med. Reinhard Schnettler,** university professor, Giessen (since June 24, 2003)

Supervisory Board members were elected for the full term specified in the Articles of Incorporation until the end of the shareholders' meeting that discharged the Board for fiscal 2007.

The shareholders' meeting held on June 24, 2003 approved the appointment of Prof. Dr Dr Reinhard Schnettler in place of Prof. Dr. Dr. h. c. Horst Cotta on the Supervisory Board provided that his term expired at the end of the shareholders' meeting that discharged the Board for fiscal 2007.

In the year under review, remuneration for members of the Supervisory Board totaled € 72,219.94. No payment was made other than an offset of € 5,000 in one instance.

Members of the Supervisory Board hold the following supervisory board directorships in addition to their work for *aap* Implantate AG:

Mr. Klaus Kosakowski:
Golf- und Country Club Seddiner See AG,
– chairman –

Mr. Prof. Dr. Friedrich-Leopold Freiherr von Stechow:
Ev. Kreditgenossenschaft eG – chairman –
Düsseldorfer Hypotekenbank
Deutsche Rettungsflugwacht e.V.
Fürstlich Castell'sche Bank, Würzburg
SMC GmbH & Co. KG

Shares and options held by Supervisory and Management Board members are as follows:

	Shares		Options	
	▶ 2003	▶ 2002	▶ 2003	▶ 2002
▶ **Supervisory Board**				
· Lothar Just	0	0	0	0
· Klaus Kosakowski	3,000	3,000	0	0
· Prof. Dr. Dr. Reinhard Schnettler	28,094	28,094	0	0
· Dr. Heinz Helge Schauwecker	0	2,966	0	0
· Dieter Borrmann	0	0	0	0
· Prof. Dr. Friedrich-Leopold Freiherr v. Stechow	0	0	0	0
· Prof. Dr. Dr. h. c. Horst Cotta	10,000	10,000	0	0
▶ **Management Board**				
· Uwe Ahrens	1,358,436	1,298,603	44,676	44,676
· Bruke Seyoum Alemu	11,520	1,000	33,506	33,506

(19) Statement on the German Corporate Governance Code

The company has issued the statement on compliance with the German Corporate Governance Code as per § 161 of the Stock Corporation Act (AktG) and made it accessible to shareholders.

(20) Events since the balance sheet date

By the terms of a contract dated May 28, 2004, a number of investors agreed to underwrite an € 8 million capital increase. The company's banks agreed by the terms of further contracts dated at the end of May 2004 to write off all loan claims against the company in return for a payment of approx. € 4.9 million in order to facilitate the company's reconstruction.

On February 20, 2004 the merger of MEBIO Medizinische Biomaterialien Vertriebs-GmbH with CORIMED Kundenorientierte Medizinprodukte GmbH was agreed as of July 1, 2003. The commercial register entries were made on March 2, 2004.

HJS Gelenk-System GmbH on March 17, 2004 served notice of termination for cause of the license agreement with *aap* Implantate AG on marketing a knee joint implant. *aap* Implantate AG disputes the validity of the termination and has inaugurated legal proceedings.

Berlin, May 28, 2004

The Management Board

Uwe Ahrens

Bruke Seyoum Alemu

Schedule of Liabilities

	31.12.2003 Total	Due Within up to 1 Year	Due Within 1–5 Years	Due Within over 5 Years	Previous Year
	€	€	€	€	T€
Due to banks	7,379,978.24	3,154,545.45	4,102,230.11	123,202.68	7,806
Advances from customers	147,960.37	147,960.37	0.00	0.00	0
Accounts payable	1,244,714.31	1,244,714.31	0.00	0.00	975
Due to affiliated companies	215,183.77	215,183.77	0.00	0.00	11
thereof accounts payable	(215,183.77)	(215,183.77)	0.00	0.00	(11)
Due to undertakings with which the company is linked by virtue of participating interests	9,914.72	9,914.72	0.00	0.00	10
Other liabilities	**1,839,917.38**	**1,503,020.48**	**336,896.90**	**0.00**	**2,532**
– thereof taxes	(64,308.29)	(64,308.29)	(0.00)	(0.00)	(492)
– thereof social security	(100,503.24)	(100,503.24)	(0.00)	(0.00)	(163)
	10,837,668.79	**6,275,339.10**	**4,439,127.01**	**123,202.68**	**11,334**

Liabilities due to banks are secured to € 7,379,978.24 by land charges and assignment of various machinery and inventories, and by assignment of receivables and pledging of patent rights.

Schedule of Fixed Asset Movements

			HISTORICAL COST
	AS AT ▶ 1.1.2003	ADDITIONS	DISPOSALS
	€	€	€
▶A **Start-up and business expansion expenses**	639,085.11	0.00	0.00
▶B **Fixed assets**			
I. Intangible assets			
1) Industrial property rights and similar rights and values	2,517,571.99	47,029.88	42,671.34
2) Goodwill	51,129.68	0.00	0.00
	2,568,701.67	**47,029.88**	**42,671.34**
II. Tangible assets			
1) Land and buildings	863,707.42	0.00	0.00
2) Plant and machinery	5,500,902.72	215,854.95	0.00
3) Other fixtures and fittings, tools and equipment	1,756,688.08	249,353.20	1,136.03
	8,121,298.22	**465,208.15**	**1,136.03**
III. Financial assets			
1) Shares in affiliated undertakings	895,966.95	0.00	0.00
2) Loans to affiliated undertakings	2,586,183.96	169,538.10	25,000.00
3) Investments	290,877.67	0.00	0.00
4) Other loans	290,158.13	3,204.78	0.00
	4,063,186.71	**172,742.88**	**25,000.00**
Total	**15,392,271.71**	**684,980.91**	**68,807.37**

Development of Capital Stock

	SUBSCRIBED CAPITAL
	€
As at 01.01.2002	4,764,265.00
Shareholder contribution as per § 272 Par. 2 No. 2 HGB	–
Net loss for the year	–
As at 31.12.2002/01.01.2003	4,764,265.00
Capital increase	105,264.00
Shareholder contribution as per § 272 Par. 2 No.1 HGB	–
Net loss for the year	–
As at 31.12.2003	4,869,529.00

Conditional capital: 476,000.00 €

		ACCUMULATED DEPRECIATION					BOOK VALUES	
	AS AT ▶ 31.12.2003	AS AT ▶ 1.1.2003	DEPRECIATION FINANCIAL YEAR	EXTRAORDINARY DEPRECIATION	DISPOSALS	AS AT ▶ 31.12.2003	AS AT ▶ 31.12.2003	AS AT ▶ 31.12.2002
	€	€	€	€	€	€	€	€
	639,085.11	639,085.11	0.00	0.00	0.00	639,085.11	0.00	0.00
	2,521,930.53	486,696.99	360,805.19	806,831.03	0.00	1,654,333.21	867,597.32	2,030,875.00
	51,129.68	51,128.68	0.00	0.00	0.00	51,128.68	1.00	1.00
	2,573,060.21	**537,825.67**	**360,805.19**	**806,831.03**	**0.00**	**1,705,461.89**	**867,598.32**	**2,030,876.00**
	863,707.42	48,239.42	308,116.00	0.00	0.00	356,355.42	507,352.00	815,468.00
	5,716,757.67	3,830,323.72	446,195.50	0.00	0.00	4,276,519.22	1,440,238.45	1,670,579.00
	2,004,905.25	1,136,569.08	273,579.99	0.00	1,136.03	1,409,013.04	595,892.21	620,119.00
	8,585,370.34	**5,015,132.22**	**1,027,891.49**	**0.00**	**1,136.03**	**6,041,887.68**	**2,543,482.66**	**3,106,166.00**
	895,966.95	0.00	0.00	0.00	0.00	0.00	895,966.95	895,966.95
	2,730,722.06	0.00	0.00	0.00	0.00	0.00	2,730,722.06	2,586,183.96
	290,877.67	0.00	84,065.08	0.00	0.00	84,065.08	206,812.59	290,877.67
	293,362.91	0.00	0.00	0.00	0.00	0.00	293,362.91	290,158.13
	4,210,929.59	**0.00**	**84,065.08**	**0.00**	**0.00**	**84,065.08**	**4,126,864.51**	**4,063,186.71**
	1,608,445.25	**6,192,043.00**	**1,472,761.76**	**806,831.03**	**1,136.03**	**8,470,499.76**	**7,537,945.49**	**9,200,228.72**

		REVENUE RESERVES			
	CAPITAL RESERVE	LEGAL RESERVE	OTHER REVENUE RESERVE	BALANCE SHEET LOSS	TOTAL
	€	€	€	€	€
	10,174,981.13	41,703.95	218,889.59	-5,186,930.71	10,012,908.96
	579,403.90	-	-	-	579,403.90
	-	-	-	-121,880.27	-121,880.27
	10,754,385.03	41,703.95	218,889.59	-5,308,810.98	10,470,432.59
	-	-	-	-	105,264.00
	94,736.00	-	-	-	94,736.00
	-	-	-	-6,805,240.34	-6,805,240.34
	10,849,121.03	41,703.95	218,889.59	-12,114,051.32	3,865,192.25

Auditor's Certification

▶ We have audited the annual financial statements of *aap* Implantate Aktiengesellschaft, including the accounts and the report on the situation of the company and the group, for the financial year from January 1, 2003 to December 31, 2003. Preparing the accounts and drawing up the annual financial statements and the report on the situation of *aap* Implantate Aktiengesellschaft (company and group) in accordance with the requirements of German commercial law are the responsibility of the company's legal representatives. Our task is to assess, on the basis of our audit, the annual financial statements of *aap* Implantate Aktiengesellschaft, including the accounts and the report on the situation of the company and the group.

We conducted our audit of the annual financial statements in accordance with § 317 of the German Commercial Code (Handelsgesetzbuch/HGB) and observing the German principles of proper auditing laid down by the Institute of Auditors (Institut der Wirtschaftsprüfer/IDW). These state that the audit is to be planned and executed in such a way as to recognize with sufficient certainty inaccuracies and infringements that have a material effect on the picture of the assets, financial and earnings position of *aap* Implantate Aktiengesellschaft (company and group) as conveyed by the annual financial statements and the report on the situation of *aap* Implantate Aktiengesellschaft (company and group), observing the German principles of proper auditing. In determining auditing activities, knowledge of the company's business activities and its economic and legal environment and expectations of possible errors are taken into account.

As a part of the audit, the efficacy of the company's in-house system of monitoring accounts and evidence of the values stated and information given in the accounts, the annual financial statements and the report on the situation of *aap* Implantate Aktiengesellschaft (company and group) were assessed mainly on the basis of random checks. The audit includes an evaluation of the accounting principles employed and of the fundamental assessments undertaken by the company's legal representatives and forming an opinion on the overall picture presented in the annual financial statements and the report on the situation of *aap* Implantate Aktiengesellschaft (company and group). We are of the opinion that our audit forms a sufficiently sound basis for our judgment.

Our audit has led to no objections.

In our considered opinion the annual financial statements, taking into account the principles of proper accounting, convey a picture of the company's assets, financial and earnings position that is an accurate reflection of the actual position. Overall, the report on the situation of *aap* Implantate Aktiengesellschaft (company and group) conveys an accurate picture of the company's position and accurately describes the risks inherent in future developments.

Without qualifying this assessment, we draw attention to the statements made in the report on the situation of the company and the group. There, under the heading "Risks inherent in future corporate developments," it is stated that the equity injection of € 8.0 million guaranteed by investors on the basis of the contract dated May 28, 2004 is subject to the conditions precedent that the resolution on the capital increase is entered in the register of companies and that the Federal Office for Financial Services (BAFin) exempts the investors from a compulsory offer as laid down in § 37 of the German Securities Acquisition and Takeover Act (WpÜG).

Berlin, May 28, 2004

Dr. Röver & Partner KG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Helmut Schuhmann
Auditor

Bettina Grothe
Auditor

Results

adjusted to DFVA/SG according to IFRS

	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
	T€	T€
1. Net loss/income for the year	-15,422	-4,520
2. Adjustments according to DFVA/SG*	11,236	0
3. Consolidated DVFA/SG result	**-4,186**	**-4,520**
4. Payable to third parties	6	0
5. Consolidated DVFA/SG result for *aap* Implantate AG stockholders	**-4,180**	**-4,429**
	€	€
Consolidated DVFA/SG earnings per share for *aap* Implantate AG stockholders	-3.20	-0.93

* extraordinary expenses

T€ corresponds to € 1,000

Cash Earnings

adjusted to DFVA/SG according to IFRS

	▶ 1.1.-31.12.2003	▶ 1.1.-31.12.2002
	T€	T€
1. Net loss/income for the year	-15,422	-4,520
2. Depreciations on fixed assets	3,510	2,881
3. Depreciation on special item for investment allowances	-152	-34
4. Adjustment according to DVFA/SG*	11,236	0
5. Consolidated DVFA/SG cash earnings	-828	-1,673
6. Payable to third parties	6	90
7. DVFA/SG cash earnings for *aap* Implantate AG stockholders	**-822**	**-1,583**
	€	€
DVFA/SG cash earnings per share for *aap* Implantate AG stockholders	-0.17	-0.33

* extraordinary expenses

T€ corresponds to € 1,000

Report by the Supervisory Board

▶ For *aap* Implantate AG, keynotes of financial year 2003 were the tense liquidity position, restructuring measures, and the development of a new business model.

The Supervisory Board performed its statutory duties and the tasks entrusted to it in the Articles of Incorporation, supervising closely the conduct of business by the company's Management Board. Orally and writing, the Management Board briefed it regularly, comprehensively and in a timely manner on the course of business, the economic situation, the business development of the company and the group, on issues of strategic and operational development, and on all other business matters of major significance. It discussed this information with the Management Board and made decisions as required by law and by the requirements of the Articles of Incorporation.

In the review period the Supervisory Board held nine meetings, including two extraordinary ones. All members of the Supervisory Board attended at least half of the meetings. Average attendance at any one meeting was 87%. Outside of these meetings, the Management Board reported regularly to the chairman and to other members of the Supervisory Board and discussed important company and group matters in one-to-one talks. The Supervisory Board set up a personnel committee that held talks with the Management Board on the renewal of contracts.

During the year under review, the Supervisory Board dealt especially with the group's tense liquidity position and with the measures initiated and implemented to improve the situation. A keynote of the Supervisory Board's deliberations was, accordingly, a continuous, detailed discussion on the group's financial position and its sales and earnings development.

Corporate planning, both strategic and operational, was discussed, and deviations from plan were analyzed. The Supervisory Board also dealt intensively with corporate planning for 2004 as submitted by the Management Board, which explained in detail deviations from previous plans and targets.

The Supervisory Board approved the appointment of an interim manager to provide support and was briefed on individual measures relating to the restructuring and cost reductions agreed. The Supervisory Board accompanied closely the talks and negotiations with the company's creditors and attended a number of meetings of pool banks. The interim manager who was appointed also reported directly to the Supervisory Board. Along with the liquidity position the financial year was characterized mainly by unsatisfactory sales figures reported by companies in the group. The restructuring of sales for the entire group was followed closely by the Supervisory Board. The appointment of a new sales manager was initiated by the Supervisory Board, which followed the progress of his appointment.

The Management Board drew up at the Supervisory Board's behest a consolidation concept providing for a strategic realignment of the *aap* Group. The concept is aimed mainly at a focus on competencies and on streamlining corporate structure.

The quest for strategic and financial investors was a further subject of detailed debate in the year under review, as were the resulting measures to continue the company's business activity. The Supervisory Board was briefed continuously on the progress of the Management Board's negotiations with investors and itself attended various discussions.

At an extraordinary meeting held on May 27, 2004 the Supervisory Board discussed once more in detail the contracts on investors acquiring an interest in the company by means of an € 8 million capital increase in cash and the redemption of all loans outstanding to banks and other individual creditors. After extensive deliberations based in part on a plausibility check of the consolidation concept by an external auditor and on the opinions expressed by *aap* Implantate AG's legal advisors, the Supervisory Board approved the contracts.

Auditors and tax accountants Dr. Röver & Partner KG, Berlin, audited the financial statement for fiscal 2002 drawn up by the Management Board, the management report and the consolidated financial statement, with its discharging effect as per § 292a of the German commercial code (HGB), including the consolidated management report, and gave them their unqualified certification. The annual financial statement and management report, the consolidated financial statement and consolidated management report and the auditor's reports were submitted to the Supervisory Board and discussed in detail. The auditor who signed the auditor's report attended the Supervisory Board's discussion of the documents submitted, reported to the Supervisory Board on the fundamental audit findings and was on hand to answer questions.

The Supervisory Board reviewed the annual financial statement and management report and the consolidated financial statement and consolidated management report. The findings of its review did not lead to objections being raised. The Supervisory Board endorsed the financial statement for the year ending December 31, 2003, which is thereby approved.

Prof. Dr. Dr. h. c. Horst Cotta retired from the Supervisory Board as of June 24, 2003. His successor, as approved by the annual meeting of shareholders held on June 24, 2003, is Prof. Dr. Dr. Reinhard Schnettler. The Supervisory Board would like to thank Prof. Dr. Dr. h. c. Cotta for his commitment and hard work in the company's interest.

The Supervisory Board would like to thank all *aap* Group employees and Management Board members for the work they have put in over the year under review.

Berlin, June 4, 2004

The Supervisory Board

Legal Rider

▶ This annual report contains forward-looking statements. These statements include forecasts on the company's products, sales and results, on *aap*'s plans for 2004 in respect of research and development activities and extension of its sales activities or with regard to *aap*'s expectations of reaching certain milestones in the development of new products. These statements are based on *aap* management assessments, on assumptions taken by *aap* and on information that is currently available to *aap*. A number of factors that *aap* cannot foresee with certainly could lead to the actual results, including *aap*'s financial position, sales revenues and earnings, differing substantially from those that are assumed expressly or implicitly in the statements.

Forward-looking statements are only valid on the date on which they are made. *aap* does not intend and assumes no undertaking to project forward-looking statements into the future or to adjust them to future events or developments.

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