

Ossur hf.

Consolidated Financial Statements

December 31st 2008

Ossur hf.
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Id-no. 560271-0189

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Report by the Board of Directors and President and CEO

It is the opinion of the Board of Directors and the President and CEO of Ossur hf., that these Consolidated Financial Statements present the necessary information to evaluate the financial position of the Company at year-end, the operating results for the year and financial developments during the year 2008. Ossur Consolidated Financial Statements are prepared in accordance with International Financial reporting standards (IFRS) as adopted by the European Union and additional Icelandic disclosure requirements for listed companies.

Ossur hf. designs, manufactures and sells orthopaedic products specializing in prosthetics, bracing and support and compression therapy solutions. The Company's headquarters are located in Iceland, but the Company owns and operates subsidiaries in the United States, Canada, France, Holland, the UK, Sweden, China and Australia. The Company sells its products world wide, but the principal market areas are North America and Europe.

The total sales of the Ossur Consolidation amounted to USD 350 million, compared to USD 335.6 million in the preceding year. This represents an increase in sales of approximately 4.3%. Net profit amounted to USD 28.5 million compared to USD 7.6 million in 2007. Earnings per Share (EPS) amounted to US cents 6.74 compared to US cents 1.94 in 2007. Earnings before interest, taxes, depreciation and amortization (EBITDA) amounted to USD 79.4 million compared to USD 64.4 million in the preceding year.

The total assets of the Ossur Consolidation amounted to USD 603.8 million at year-end, liabilities were 354.1 million, and equity was 249.6 million. The equity ratio at year-end was 41%, compared to 39% the preceding year.

In the course of the year the Company employed on average 1,587 employees, of which 268 were employed by the parent company in Iceland.

The share price of the Company was 99.8 at year-end, compared to 98.5 at the beginning of the year. The market value of the Company at year-end was 349 million USD and decreased by 48% over the year, due to exchange rate developments as the shares are listed in ISK. At year end, shareholders in Ossur hf. numbered 2,586 compared to 2,842 at the beginning of the year. Two shareholders owned more than 10% of the shares in the Company at year-end: William Demant Invest A/S, with 34.3% and Eyrir Invest ehf. Holding 19.9%.

At 31 March Ossur discontinued its Advanced Wound Care product line with the sale to BSN medical GmbH.

In its procedures, the Board of Directors complies with the Articles of Association of the Company and Internal Rules of Procedure. The rules comply with the guideline on Corporate Governance issued by the Icelandic Stock Exchange, the Iceland Chamber of Commerce and SA-Confederation of Icelandic Employers. The Internal Rules address issues such as allocation of responsibilities and power of decision within the Board, independency issues, confidentiality etc. An Audit Committee has not been set up within the Board and the Board itself handles all issues that would be decided by an Audit Committee. A Compensation Committee is present within the Board. The Compensation Committee decides on compensation for the President & CEO. No Ossur employees are sitting on the Board of Directors.

The Board of Directors does not recommend payment of dividends to shareholders in 2009. As regards changes in the equity of the Company, the Board refers to the Notes attached to the Consolidated Financial Statements.

Report by the Board of Directors and President and CEO

The Board of Directors and President and CEO of Ossur hf. hereby confirm the Consolidated Financial Statements of Ossur for the year 2008 with their signatures.

Reykjavik, 4 February 2009

Board of Directors

Niels Jacobsen
Chairman of the Board

Ossur Kristinsson

Kristjan T. Ragnarsson

Thordur Magnusson

Svafa Gronfeldt

President and CEO

Jon Sigurdsson

Financial Ratios

Consolidated statement

| | | 2008 | 2007 | 2006 | 2005 | 2004 |
|--|----------|---------|---------|---------|---------|---------|
| Growth | | | | | | |
| Net sales | USD '000 | 350,017 | 335,609 | 252,133 | 160,729 | 124,399 |
| EBITDA | USD '000 | 79,440 | 64,392 | 39,493 | 25,832 | 25,045 |
| Profit from operations | USD '000 | 55,958 | 39,716 | 19,743 | 16,525 | 20,374 |
| Employees | Number | 1,587 | 1,617 | 1,190 | 680 | 568 |
| Net income | USD '000 | 28,488 | 7,580 | 4,360 | 11,688 | 15,227 |
| Total assets | USD '000 | 603,778 | 635,821 | 612,752 | 407,986 | 108,915 |
| Operational performance | | | | | | |
| Cash provided by operating activities | USD '000 | 52,835 | 45,701 | 15,988 | 15,481 | 16,600 |
| - as ratio to total debt | % | 14 | 11 | 5 | 10 | 30 |
| - as ratio to net result | | 1.9 | 6.0 | 3.7 | 1.3 | 1.1 |
| Working capital from operating activities | USD '000 | 58,070 | 43,991 | 24,663 | 18,954 | 23,095 |
| - as ratio to long-term debt and Equity | % | 15 | 11 | 6 | 8 | 27 |
| - as ratio to investm., current maturities, divid. | | 2.6 | 1.2 | 0.1 | 0.1 | 0.8 |
| Liquidity and solvency | | | | | | |
| Quick ratio | | 0.7 | 0.5 | 0.4 | 1.4 | 1.4 |
| Current ratio | | 1.1 | 0.9 | 0.6 | 2.1 | 2.2 |
| Equity ratio | % | 41 | 39 | 26 | 37 | 50 |
| Asset utilization and efficiency | | | | | | |
| Net sales pr. employee | USD '000 | 221 | 208 | 212 | 236 | 219 |
| Total asset turnover | | 0.6 | 0.5 | 0.5 | 0.6 | 1.2 |
| Grace period granted | Days | 49 | 55 | 46 | 44 | 44 |
| Profitability | | | | | | |
| Return on capital | % | 9 | 5 | 5 | 10 | 20 |
| Return on common equity | % | 11 | 4 | 3 | 15 | 31 |
| Operating profit as ratio to net sales | % | 16 | 12 | 8 | 10 | 16 |
| Net income before taxes as ratio to net sales | % | 11 | 2 | 0 | 8 | 15 |
| Net income for the period as ratio to net sales | % | 8 | 2 | 2 | 7 | 12 |
| Market | | | | | | |
| Market value of equity | USD '000 | 349,263 | 672,024 | 605,572 | 695,125 | 395,514 |
| Price/earnings ratio, (P/E) | | 12.3 | 88.7 | 138.9 | 59.5 | 26.0 |
| Price/book ratio | | 1.4 | 2.7 | 3.7 | 4.5 | 7.2 |
| Number of shares | Millions | 423 | 423 | 385 | 385 | 318 |
| Earnings per Share, (EPS) | US Cent | 6.74 | 1.94 | 1.13 | 3.53 | 4.80 |
| Diluted Earnings per Share, (Diluted EPS) | US Cent | 6.73 | 1.94 | 1.13 | 3.52 | 4.80 |
| Cash EPS | US Cent | 12.29 | 8.24 | 6.27 | 6.34 | 6.28 |
| Diluted Cash EPS | US Cent | 12.29 | 8.24 | 6.27 | 6.33 | 6.27 |

Independent Auditor's Report

To the Board of Directors and shareholders of Ossur hf.

We have audited the accompanying Consolidated Financial Statements of Ossur hf., which comprise the balance sheet as at December 31, 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by the European Union Union and additional Icelandic disclosure requirements for listed companies. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Consolidated Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our own audit and the audit reports on the Consolidated Financial Statements of the foreign subsidiaries of Ossur hf., the Consolidated Financial Statements give a true and fair view of the financial position of Ossur hf. and subsidiaries as of December 31, 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and additional Icelandic disclosure requirements for listed companies.

Kopavogur, 4 February 2009

Deloitte hf.

Sigurdur Pall Hauksson
State Authorized Public Accountant

Thorsteinn Petur Gudjonsson
State Authorized Public Accountant

Consolidated Income Statements for the years 2008 and 2007

| | Notes | 2008 | 2007 | Unaudited | |
|---|-------|-----------|-----------|------------|------------|
| | | | | 2008 Q4 | 2007 Q4 |
| Net sales | 5 | 350,017 | 335,609 | 80,118 | 84,870 |
| Cost of goods sold | | (143,663) | (146,754) | (32,953) | (38,643) |
| Gross profit | | 206,354 | 188,855 | 47,165 | 46,227 |
| Other income | 8 | 9,433 | 12,033 | (49) | 11,205 |
| Sales and marketing expenses | | (89,963) | (85,152) | (21,017) | (21,150) |
| Research and development expenses | | (20,930) | (19,887) | (5,027) | (5,180) |
| General and administrative expenses | | (48,936) | (56,132) | (10,257) | (14,945) |
| Profit from operations | | 55,958 | 39,716 | 10,815 | 16,157 |
| Financial income | 11 | 864 | 10,590 | 639 | 4,751 |
| Financial expenses | 11 | (18,589) | (42,253) | (6,608) | (13,196) |
| Profit before tax | | 38,233 | 8,053 | 4,846 | 7,712 |
| Income tax | 12 | (9,745) | (473) | (675) | (1,064) |
| Net profit | | 28,488 | 7,580 | 4,171 | 6,648 |
| Earnings per Share | 13 | | | | |
| Basic Earnings per Share | | 6.74 | 1.94 | 0.99 | 1.70 |
| Diluted Earnings per Share | | 6.73 | 1.94 | 0.99 | 1.70 |

Consolidated Balance Sheets

Assets

| | Notes | 31.12.2008 | 31.12.2007 |
|-------------------------------------|-------|----------------|----------------|
| Non-current assets | | | |
| Property, plant and equipment | 15 | 32,927 | 35,970 |
| Goodwill | 16 | 322,381 | 342,359 |
| Other intangible assets | 17 | 45,175 | 61,797 |
| Financial assets | 19 | 1,156 | 1,835 |
| Deferred tax asset | 28 | 56,407 | 61,603 |
| | | 458,046 | 503,564 |
| Current assets | | | |
| Inventories | 21 | 55,818 | 54,277 |
| Accounts receivables | 22 | 43,821 | 47,405 |
| Other receivables | 22 | 9,828 | 10,706 |
| Financial assets | 19 | 203 | 713 |
| Tax asset | 28 | 5,156 | 3,267 |
| Bank balances and cash | 20 | 30,906 | 15,889 |
| | | 145,732 | 132,257 |
| Total assets | | 603,778 | 635,821 |

31 December 2008 and 31 December 2007

Equity and liabilities

| | Notes | 31.12.2008 | 31.12.2007 |
|-------------------------------------|-------|----------------|----------------|
| Equity | | | |
| Issued capital | 23 | 172,902 | 173,298 |
| Reserves | 24 | (4,257) | 24,307 |
| Retained earnings | 25 | 81,003 | 52,677 |
| | | <u>249,648</u> | <u>250,282</u> |
| Non-current liabilities | | | |
| Borrowings | 27 | 183,117 | 207,417 |
| Deferred tax liabilities | 28 | 25,870 | 28,826 |
| Provisions | 29 | 3,575 | 3,118 |
| Financial liabilities | 19 | 9,474 | 0 |
| | | <u>222,036</u> | <u>239,361</u> |
| Current liabilities | | | |
| Borrowings | 27 | 82,070 | 91,578 |
| Accounts payable | | 13,593 | 15,249 |
| Deferred tax liabilities | 28 | 1,206 | 1,778 |
| Tax liabilities | | 1,434 | 3,566 |
| Provisions | 29 | 7,659 | 6,923 |
| Other liabilities | 30 | 26,132 | 27,084 |
| | | <u>132,094</u> | <u>146,178</u> |
| Total equity and liabilities | | <u>603,778</u> | <u>635,821</u> |

Consolidated Statements of Cash Flows

for the years 2008 and 2007

| | Notes | 2008 | 2007 |
|--|--------|-----------------|-----------------|
| Cash flows from operating activities | | | |
| Profit from operations | | 55,958 | 39,716 |
| Depreciation and amortization | 15, 17 | 23,482 | 24,676 |
| Gain on disposal of assets | | 40 | 113 |
| Changes in operating assets and liabilities | | (8,020) | (2,977) |
| Cash generated by operations | | <u>71,460</u> | <u>61,528</u> |
| Interest received | | 283 | 10,554 |
| Interest paid | | (16,948) | (23,376) |
| Taxes paid | | (1,960) | (3,005) |
| Net cash provided by operating activities | | <u>52,835</u> | <u>45,701</u> |
| Cash flows from investing activities | | | |
| Purchase of fixed assets | 15, 17 | (7,754) | (7,126) |
| Proceeds from sale of fixed assets | | 959 | 266 |
| Acquisition of subsidiaries | | 0 | (10,842) |
| Changes in financial assets | | 147 | (79) |
| | | <u>(6,648)</u> | <u>(17,781)</u> |
| Cash flows from financing activities | | | |
| Repayments of short-term borrowings | | (14,271) | (87,693) |
| Proceeds from long-term borrowings | | 0 | 15,605 |
| Repayments of long-term borrowings | | (15,943) | (18,945) |
| Paid in share capital | | 0 | 65,744 |
| Cost due to increasing capital | 23 | (396) | 0 |
| | | <u>(30,610)</u> | <u>(25,289)</u> |
| Net change in cash | | 15,577 | 2,631 |
| Effects of foreign exchange adjustments | | (560) | 1,080 |
| Cash at beginning of year | | 15,889 | 12,178 |
| Cash at end of year | | 30,906 | 15,889 |
| Additional information regarding cash flow | | 14 | |

Consolidated Statement of changes in Equity for the period ended 31 December 2008

| | Share capital | Share premium | Statutory reserve | Stock option reserve | Hedging reserve | Translation reserve | Accumulated profits | Total equity |
|--|------------------|------------------|----------------------|-------------------------|--------------------|------------------------|------------------------|-----------------|
| Balance at 1 January 2007..... | 4,170 | 103,383 | 1,043 | 0 | 0 | 7,947 | 45,096 | 161,640 |
| Loss on hedge of a net investment in foreign operations..... | | | | | | (10,599) | | (10,599) |
| Gain on cash flow hedges..... | | | | | 552 | | | 552 |
| Translation difference of shares in foreign companies..... | | | | | | 25,031 | | 25,031 |
| Net gains not recognised in the income statement..... | 0 | 0 | 0 | 0 | 552 | 14,432 | 0 | 14,984 |
| Issue of ordinary shares..... | 651 | 65,093 | | | | | | 65,744 |
| Share option charge for the year..... | | | | 332 | | | | 332 |
| Net profit..... | | | | | | | 7,580 | 7,580 |
| Balance at 31 December 2007..... | 4,821 | 168,477 | 1,043 | 332 | 552 | 22,379 | 52,677 | 250,282 |
| Gain on hedge of a net investment in foreign operations net of tax..... | | | | | | 1,252 | | 1,252 |
| Loss on cash flow hedges net of tax..... | | | | | | (8,605) | | (8,605) |
| Translation difference of shares in foreign operations..... | | | | | | (22,029) | | (22,029) |
| Net loss not recognised in the income statement..... | 0 | 0 | 0 | 0 | (8,605) | (20,777) | 0 | (29,382) |
| Cost due to increasing capital..... | | (396) | | | | | | (396) |
| Share option charge for the year..... | | | | | 657 | | | 657 |
| Transferred to statutory reserves..... | | | 162 | | | | (162) | 0 |
| Net profit..... | | | | | | | 28,488 | 28,488 |
| Balance at 31 December 2008..... | 4,821 | 168,081 | 1,205 | 989 | (8,053) | 1,602 | 81,003 | 249,648 |

Notes to the Financial Statements

1. General information

Ossur hf. is a global orthopaedics company, specializing in the development, manufacturing and sales of prosthetics, bracing and support and compression therapy products. The principal market areas of the Company are Americas, Europe, Middle East and Africa (EMEA) and Asia, which are served by subsidiaries in the United States, Canada, Sweden, the Netherlands, UK, France, Australia and China in addition to the Iceland-based parent company.

The main production of the Company is conducted at Ossur hf. in Iceland, Gibaud Group (La Tour Finance) in St. Etienne, Trevoux in France and at Ossur Americas in California USA. Part of the production is outsourced to Asia.

According to the Company's organizational structure, the consolidation is divided into four main functions; Corporate Finance, responsible for overall financial management; Manufacturing & Operations, responsible for all production, inventory management and distribution; Research & Development, responsible for product development, product management and quality control; Sales & Marketing responsible for sales and marketing through the subsidiaries.

2. Adoption of new and revised Standards

2.1 Standards and interpretations effective in the current period

The Financial Statements is presented in accordance with the new and revised standards (IFRS / IAS) and new interpretations (IFRIC), applicable to financial years in the year 2008. These standards and interpretations are:

| | |
|------------------|--|
| IAS 39 | Financial Instruments: Recognition and Measurement (amended 2008) |
| IFRIC 11, IFRS 2 | Group and treasury share transactions |
| IFRIC 12 | Service concession arrangements |
| IAS 19, IFRIC 14 | The limit on a defined benefit asset, minimum funding requirements and their interaction |

The adoption of the new and revised standard and interpretations has not led to changes in the accounting policies.

2.2 Standards and interpretations in issue not yet adopted

Following is an overview of new standards, amendments to standards and interpretations that are not yet effective for the year end, but will be effective in 2009.

| | |
|----------|--|
| IFRS 2 | Share-based Payment (amended 2008) |
| IFRS 3 | Business Combinations (amended 2008) |
| IFRS 8 | Operating Segments |
| IAS 1 | Presentation of Financial Statements |
| IAS 23 | Borrowing Costs (amended 2008) |
| IAS 27 | Consolidated financial statements and separate financial statements (amended 2008) |
| IAS 39 | Financial Instruments: Recognition and Measurement (amended 2008) |
| IFRIC 13 | Customer loyalty programs |
| IFRIC 15 | Agreements for the construction of real estates |
| IFRIC 16 | Hedges of a net investments in a foreign operations |
| IFRIC 17 | Distributions of non-cash assets for owners. |

It is the management's assessment that the adoption of the above standards will not have material effect on the financial statements, except for the additional disclosure requirements for operating segments according to IFRS 8.

Notes to the Financial Statements

3. Summary of Significant Accounting Policies

3.1 Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional disclosure requirements for Consolidated Financial Statements for listed companies.

3.2 Basis of preparation

The Consolidated Financial Statements have been prepared on the historical cost basis except for the revaluation of certain non-current assets and financial instruments. The Financial Statements are presented in USD, which is the Company's functional currency. The principal accounting policies are set out below.

3.3 Basis of consolidation

The Consolidated Financial Statements incorporate the Financial Statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee enterprise so as to obtain benefits from its activities.

The results of subsidiaries acquired during the year are included in the consolidated income statement from the effective date of acquisition as appropriate. Where necessary, adjustments are made to the Financial Statements of subsidiaries to bring their accounting policies into line with those used by other members of the Company.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

3.4 Business Combination

Acquisitions of subsidiaries and businesses are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 Business Combinations are recognised at their fair values at the acquisition date, except for non-current assets (or disposal Company's) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Company's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

3.5 Goodwill

Goodwill arising on the acquisition of a subsidiary or a jointly controlled entity represents the excess of the cost of acquisition over the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary or jointly controlled entity recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Company's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary or a jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Notes to the Financial Statements

3.6 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Sale of goods

Revenue from the sale of goods is recognised when all the following conditions are satisfied; the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the entity and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Royalties

Royalty revenue is recognised on an accrual basis in accordance with the substance of the relevant agreement. Royalties determined on a time basis are recognised on a straight-line basis over the period of the agreement. Royalty arrangements that are based on production, sales and other measures are recognised by reference to the underlying arrangement.

Interest revenue

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

3.7 Leasing

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

3.8 Foreign currencies

The individual Financial Statements of each Company's entity are presented in the currency of the primary economic environment in which the entity operates in. For the purpose of the Consolidated Financial Statements, the results and financial position of each entity are expressed in USD, which is the functional currency of the Company and the presentation currency for the Consolidated Financial Statements. Currency used for translating to USD is derived from the Central Bank of Iceland.

In preparing the Financial Statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in profit or loss in the period, except exchange differences relating to hedge of a net investment in foreign operations.

For the purpose of presenting Consolidated Financial Statements, the assets and liabilities of the Company's foreign operations are expressed in USD using exchange rates prevailing at the balance sheet date. Income and expense items are translated at the average exchange rates for each quarter within the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are classified as equity and transferred to the Company's translation reserve. Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

Notes to the Financial Statements

3.9 Borrowing costs

Debt issuance cost is capitalized and amortized over the term of the long-term loans, other borrowing costs are recognised in profit or loss in the period in which they are incurred.

3.10 Pension obligation

Pension obligation is recognised at fair value in the balance sheet. Contributions to the Company's pension obligation is charged to the profit and loss account in the period vested.

3.11 Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the period. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other periods and it further excludes items that are never taxable or deductible. The consolidated Company's current tax liability is calculated using the tax rates for each country.

Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the Consolidated Financial Statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

In the preparation of the Consolidated Financial Statements, accumulated gains in inventories from intercompany transactions are eliminated. This has an effect on the income tax expenses of the consolidated companies, and an adjustment is included in the deferred tax asset. Income tax expense is calculated in accordance with tax rates in the countries where the inventories originate.

Notes to the Financial Statements

3.12 Property, plant and equipment

Property, plant and equipment are recognised as an asset when it is probable that future economic benefits associated with the asset will flow to the consolidation and the cost of the asset can be measured in a reliable manner.

Property, plant and equipment which qualifies for recognition as an asset is initially measured at cost.

The cost of a property, plant and equipment comprises its purchase price and any directly attributable cost of bringing the asset to working condition for its intended use.

The depreciable amount of the asset is allocated on a straight-line basis over its useful life. The depreciation charge for each period is recognised as an expense.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

3.13 Intangible assets

Intangible assets acquired separately

Intangible assets acquired separately are reported at cost less accumulated amortisation and accumulated impairment losses. Amortisation is charged on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Internally-generated intangible assets - research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from the Company's development is recognised only if all of the following conditions are met: the technical feasibility of completing the intangible asset so that it will be available for use or sale; the intention to complete the intangible asset and use or sell it; the ability to use or sell the intangible asset; how the intangible asset will generate probable future economic benefits; the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset and the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible assets are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

Intangible assets acquired in a business combination

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair values can be measured reliably. The cost of such intangible assets is their fair value at the acquisition date.

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

Notes to the Financial Statements

3.14 Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

3.15 Inventories

Inventories are stated at the lower of cost and net realisable value. Costs, including an appropriate portion of fixed and variable overhead expenses, are assigned to inventories held by the method most appropriate to the particular class of inventory, with the majority being valued on a standard cost basis. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

3.16 Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Notes to the Financial Statements

Restructurings

A restructuring provision is recognised when the Company has developed a detailed formal plan for the restructuring and has started to implement it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

Warranties

Provisions for warranty costs are recognised at the date of sale of the relevant products, at the directors' best estimate of the expenditure required to settle the Company's obligation.

3.17 Risk management

Financial risk management is governed by the Company's Financial Risk Management Policy, approved by the Board of Directors. The policy sets limits to the extent of financial risks and guidelines for financial transactions in general. The general policy is to apply natural currency hedging to the extent possible and prohibit any speculative trading of financial instruments.

Long term financing is managed from the Company's Corporate Finance function and individual subsidiaries do not engage in substantial external financing contracts with banks and/or credit institutions.

The Company is outset for normal business risk in collecting accounts receivable. Adequate allowance is made for bad debt expenses.

3.18 Financial assets

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets as 'at fair value through profit or loss' (FVTPL), 'held-to-maturity investments', 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at fair value through profit or loss

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset.

Notes to the Financial Statements

Loans and receivables

Account receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For certain categories of financial asset, such as account receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the companies average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

3.19 Financial liabilities

Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Notes to the Financial Statements

3.20 Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risk, including foreign exchange forward contracts and interest rate swaps. Further details of derivative financial instruments are disclosed in note 30.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Company designates certain derivatives as either hedges of the fair value of recognised assets or hedges of net investments in foreign operations.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Hedge accounting

The Company designates certain hedging instruments, which include derivatives and non-derivatives in respect of foreign currency risk, as either cash flow hedges or hedges of net investments in foreign operations. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship the entity documents the relationship between the hedging instrument and hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

Note 31 sets out details of the fair values of the derivative instruments used for hedging purposes. Movements in the hedging reserve in equity are also detailed in note 24.

Hedges of net investments in foreign operations

Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity in the foreign currency translation reserve.

Gains and losses deferred in the foreign currency translation reserve are recognised in profit or loss on disposal of the foreign operation.

4. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, which are described in note 3, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

These estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Determining whether goodwill is impaired requires an estimations of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

As described at 3.12 above, the Company reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period.

Notes to the Financial Statements

5. Net sales

| | 2008 | 2007 |
|---------------|----------------|----------------|
| Americas..... | 163,204 | 162,025 |
| EMEA..... | 173,858 | 163,089 |
| Asia..... | 12,955 | 10,495 |
| | <u>350,017</u> | <u>335,609</u> |

Net sales are specified as follows according to currency:

| | 2008 | 2007 |
|-----------------------------|----------------|----------------|
| US Dollar, USD..... | 168,740 | 166,336 |
| Euro, EUR..... | 116,654 | 104,777 |
| British Pound, GBP..... | 24,789 | 26,099 |
| Canadian dollar, CAD..... | 15,379 | 15,145 |
| Swedish Krona, SEK..... | 12,151 | 11,104 |
| Norwegian Krona, NOK..... | 6,602 | 6,097 |
| Australian Dollar, AUD..... | 2,258 | 2,193 |
| Icelandic Krona, ISK..... | 1,791 | 2,343 |
| Other..... | 1,653 | 1,515 |
| | <u>350,017</u> | <u>335,609</u> |

Notes to the Financial Statements

6. Geographical segments

The Company uses geographical markets as its primary segments. Segment information is presented below, according to location of customers:

| 2008 | Americas | EMEA | Asia | Eliminations | Consolidated |
|--------------------------|----------------|----------------|---------------|------------------|----------------|
| | 2008 | 2008 | 2008 | 2008 | 2008 |
| Revenue | | | | | |
| External sales..... | 163,204 | 173,858 | 12,955 | 0 | 350,017 |
| Inter-segment sales..... | 26,712 | 75,787 | 0 | (102,498) | 0 |
| Total revenue..... | <u>189,915</u> | <u>249,645</u> | <u>12,955</u> | <u>(102,498)</u> | <u>350,017</u> |

Inter-segment sales are calculated from production cost.

Result

| | | | | | |
|----------------------------------|---------------|---------------|--------------|----------|---------------|
| Segment result..... | <u>21,892</u> | <u>30,612</u> | <u>3,454</u> | <u>0</u> | 55,958 |
| Financial income/(expenses)..... | | | | | (17,725) |
| Profit before tax..... | | | | | 38,233 |
| Income tax..... | | | | | (9,745) |
| Net profit..... | | | | | <u>28,488</u> |

Other information

| | | | | | |
|------------------------------------|--------|-------|-----|---|--------|
| Capital additions..... | 2,073 | 5,184 | 497 | 0 | 7,754 |
| Depreciation and amortization..... | 13,533 | 9,887 | 62 | 0 | 23,482 |

Balance sheet

| | 31.12.2008 | 31.12.2008 | 31.12.2008 | 31.12.2008 | 31.12.2008 |
|--------------------------|------------|------------|------------|------------|----------------|
| Assets | | | | | |
| Segment assets..... | 406,532 | 926,189 | 4,245 | (733,188) | <u>603,778</u> |
| Liabilities | | | | | |
| Segment liabilities..... | 295,042 | 553,895 | 6,353 | (501,160) | <u>354,130</u> |

Notes to the Financial Statements

| 2007 | Americas 2007 | EMEA 2007 | Asia 2007 | Eliminations 2007 | Consolidated 2007 |
|------------------------------------|------------------|----------------|---------------|----------------------|----------------------|
| Revenue | | | | | |
| External sales..... | 162,025 | 163,089 | 10,495 | 0 | 335,609 |
| Inter-segment sales..... | 19,875 | 62,216 | 1 | (82,092) | 0 |
| Total revenue..... | <u>181,900</u> | <u>225,305</u> | <u>10,496</u> | <u>(82,092)</u> | <u>335,609</u> |
| Result | | | | | |
| Segment result..... | <u>13,938</u> | <u>24,333</u> | <u>240</u> | <u>1,205</u> | <u>39,716</u> |
| Financial income/(expenses)..... | | | | | (31,663) |
| Profit before tax..... | | | | | 8,053 |
| Income tax..... | | | | | (473) |
| Net profit..... | | | | | <u>7,580</u> |
| Other information | | | | | |
| | Americas | EMEA | Asia | Eliminations | Consolidated |
| Capital additions..... | 2,939 | 3,991 | 196 | 0 | 7,126 |
| Depreciation and amortization..... | 16,505 | 8,138 | 33 | 0 | 24,676 |
| Balance sheet | | | | | |
| | 31.12.2007 | 31.12.2007 | 31.12.2007 | 31.12.2007 | 31.12.2007 |
| Assets | | | | | |
| Segment assets..... | 406,366 | 964,964 | 3,302 | (738,811) | <u>635,821</u> |
| Liabilities | | | | | |
| Segment liabilities..... | 297,307 | 602,016 | 3,555 | (517,339) | <u>385,539</u> |

Notes to the Financial Statements

7. Business segments

Current business segments for the Company are Prosthetics, Bracing and Support, Compression Therapy and other products. It is not possible to disclose assets according to business segments due to shared usage of assets.

Net sales are specified as follows according to product lines:

| | 2008 | 2007 |
|---------------------------------------|----------------------|----------------------|
| Prosthetics..... | 143,218 | 131,722 |
| Bracing and support..... | 181,359 | 179,839 |
| Compression Therapy (Phlebology)..... | 20,082 | 19,107 |
| Other products..... | 5,358 | 4,941 |
| | <hr/> <u>350,017</u> | <hr/> <u>335,609</u> |

8. Other Income

Included in other income is a gain amounting to 8.4 million USD related to sale of the Advanced Wound Care product line to BSN medical GmbH, a leading global provider of wound care products. Following this sale the Company settled on 15 September 2008 all intellectual property litigation related to the Advanced Wound Care product line.

Included in other income in 2007 is a gain from the sale of the option to buy the Companies facilities in Iceland and a legal settlement amounting to USD 10.9 million.

Notes to the Financial Statements

9. Salaries

Salaries and salary-related expenses, paid by the consolidation, are specified as follows:

| | 2008 | 2007 |
|-----------------------------------|----------------|----------------|
| Salaries | 85,273 | 82,593 |
| Salary-related expenses | 27,751 | 30,650 |
| | <u>113,023</u> | <u>113,244</u> |
| Average number of positions | 1,587 | 1,617 |

Salaries and salary-related expenses, classified by operational category, are specified as follows:

| | 2008 | 2007 |
|----------------------------------|----------------|----------------|
| Cost of goods sold | 41,525 | 39,616 |
| Sales and marketing | 43,826 | 43,478 |
| Research and development | 7,235 | 7,993 |
| General and administrative | 20,438 | 22,157 |
| | <u>113,023</u> | <u>113,244</u> |

Management salaries and benefits

| | Salaries and related exp. | Stock options | Shares owned |
|---|------------------------------|------------------|-----------------|
| Board of Directors: | | | |
| Niels Jacobsen Chairman of the Board..... | 50 | 0 | 0 |
| Thordur Magnusson Vice Chairman (i)..... | 30 | 0 | 84,040,215 |
| Ossur Kristinsson (ii)..... | 61 | 0 | 37,526,769 |
| Kristjan Tomas Ragnarsson..... | 20 | 0 | 619,539 |
| Svafa Gronfeldt..... | 20 | 0 | 0 |

Executive committee:

| | | | |
|---|-----|-----------|------------|
| Jon Sigurdsson President and CEO..... | 754 | 1,250,000 | 24,458,841 |
| Hjorleifur Palsson CFO..... | 439 | 308,000 | 700,000 |
| Egill Jonsson VP of Manufacturing & Operations..... | 333 | 308,000 | 18,499 |
| Hilmar Bragi Janusson VP of R&D..... | 397 | 308,000 | 3,660,347 |
| Mahesh Mansukhani Presid. of S&M America..... | 250 | 500,000 | 0 |
| Eythor Bender former Presid. of S&M America..... | 753 | 0 | 0 |
| Olafur Gylfason Man. Director S&M EMEA..... | 317 | 308,000 | 476,368 |

The shares owned by members of the board and executive committee are either owned by them personally or through holding companies.

(i) Shares owned by Eyrir Invest ehf. of which Thordur Magnusson owns 20% and is the Chairman of the Board.

(ii) Shares owned by Mallard Holding which is owned by the founder of the company Ossur Kristinsson and his family.

No trading transactions were entered with related parties during the year.

Notes to the Financial Statements

10. Fees to Auditors

| | 2008 | 2007 |
|---|--------------|--------------|
| Audit of Financial Statements..... | 710 | 730 |
| Review of Interim Financial Statements..... | 252 | 416 |
| Other services..... | 235 | 229 |
| | <u>1,198</u> | <u>1,375</u> |

11. Financial income / (expenses)

Interest income and (expenses) are specified as follows:

| | 2008 | 2007 |
|--|-----------------|-----------------|
| Financial income: | | |
| Bank deposit..... | 204 | 1,527 |
| Income from financial assets..... | 0 | 346 |
| Fair value changes of derivatives..... | 640 | 8,700 |
| Other interest income..... | 20 | 17 |
| | <u>864</u> | <u>10,590</u> |
| Finance expenses: | | |
| Interest on bank overdrafts and loans..... | (17,627) | (25,167) |
| Expenses from financial assets..... | (131) | 0 |
| Other interest expenses..... | (545) | (551) |
| | <u>(18,303)</u> | <u>(25,718)</u> |
| Exchange rate differences..... | (286) | (16,535) |
| | <u>(18,589)</u> | <u>(42,253)</u> |
| Net finance costs..... | <u>(17,725)</u> | <u>(31,663)</u> |

The Company uses derivative financial instruments to hedge part of its foreign currency and interest rate risk exposures when applicable. The principal derivative instruments used are interest rate swaps and foreign currency swaps.

Notes to the Financial Statements

12. Income tax

Income tax is specified as follows:

| | 2008 | 2007 |
|---|----------------|--------------|
| Current tax expenses..... | (465) | (5,543) |
| Deferred tax (expenses) / revenue | (9,280) | 5,070 |
| | <u>(9,745)</u> | <u>(473)</u> |

| | 2008 | | 2007 | |
|---|----------------|------------|--------------|-------------|
| | Amount | % | Amount | % |
| Profit before taxes..... | <u>38,233</u> | | <u>8,053</u> | |
| Income tax revenue calculated at 15%/18%..... | (5,735) | 15% | (1,449) | 18% |
| Effect of different tax rates of other jurisdictions..... | (1,585) | 4% | 4,226 | (52%) |
| Effect of nondeductible expenses/revenues..... | (1,126) | 3% | (837) | 10% |
| Effect of change in tax rate..... | (590) | 2% | (2,628) | 33% |
| Effect of previously recognised tax loss reversed..... | 0 | 0% | (276) | 3% |
| Other changes..... | <u>(709)</u> | <u>2%</u> | <u>490</u> | <u>(6%)</u> |
| | <u>(9,745)</u> | <u>25%</u> | <u>(473)</u> | <u>6%</u> |

During the year the income tax rate in Iceland changed from 18% to 15%. The effect on the Income Statement due to changes in tax rates amount to USD 590 thousand.

13. Earnings per share

The calculation of Earnings per Share is based on the following data:

| | 2008 | 2007 |
|--|----------------|----------------|
| Net profit..... | <u>28,488</u> | <u>7,580</u> |
| Total average number of shares outstanding during the year (in thousands)..... | <u>422,982</u> | <u>394,405</u> |
| Total average number of shares including potential shares (in thousands)..... | <u>423,026</u> | <u>391,295</u> |
| Basic Earnings per Share (US cent) | 6.74 | 1.94 |
| Diluted Earnings per Share (US cent) | 6.73 | 1.94 |
| Cash Earnings per Share | 12.29 | 8.24 |
| Diluted Cash Earnings per Share | 12.29 | 8.24 |

Notes to the Financial Statements

14. Additional information regarding cash flow

| | 2008 | 2007 |
|--|---------------|---------------|
| Net profit | 28,488 | 7,580 |
| Items not affecting cash | 29,582 | 36,411 |
| Working capital provided by operating activities | 58,070 | 43,991 |
| Increase in inventories | (4,567) | (7,423) |
| Decrease in receivable | 535 | 5,454 |
| (Decrease) / Increase in payables | (1,203) | 3,679 |
| Net cash provided by operating activities | <u>52,835</u> | <u>45,701</u> |

15. Property, plant and equipment

Operating fixed assets are specified as follows:

| | Buildings & sites | Machinery & equipment | Fixtures & office equip. | Total |
|---------------------------------|----------------------|--------------------------|-----------------------------|---------------|
| Cost | | | | |
| At 1 January 2008..... | 17,274 | 34,286 | 28,182 | 79,742 |
| Additions..... | 419 | 3,870 | 3,465 | 7,754 |
| Exchange differences..... | (620) | (1,880) | (1,025) | (3,525) |
| Eliminated on disposal..... | 0 | (1,776) | (794) | (2,570) |
| Fully depreciated assets..... | 0 | (471) | 0 | (471) |
| At 31 December 2008..... | <u>17,073</u> | <u>34,029</u> | <u>29,828</u> | <u>80,930</u> |
| Accumulated depreciation | | | | |
| At 1 January 2008..... | 8,351 | 20,731 | 14,690 | 43,772 |
| Charge for the year..... | 525 | 3,339 | 4,863 | 8,727 |
| Exchange differences..... | (355) | (1,515) | (585) | (2,455) |
| Eliminated on disposal..... | 0 | (954) | (616) | (1,570) |
| Fully depreciated assets..... | 0 | (471) | 0 | (471) |
| At 31 December 2008..... | <u>8,521</u> | <u>21,130</u> | <u>18,352</u> | <u>48,003</u> |
| Carrying Amount | | | | |
| At 31 December 2008..... | <u>8,552</u> | <u>12,899</u> | <u>11,476</u> | <u>32,927</u> |
| At 31 December 2007..... | <u>8,923</u> | <u>13,555</u> | <u>13,492</u> | <u>35,970</u> |

Depreciation classified by operational category, is shown in the following schedule:

| | 2008 | 2007 |
|---|--------------|--------------|
| Cost of goods sold | 3,507 | 3,027 |
| Sales and marketing expenses | 678 | 320 |
| Research and development expenses..... | 319 | 236 |
| General and administrative expenses | 4,223 | 5,447 |
| | <u>8,727</u> | <u>9,029</u> |

The following rates are used for the depreciation:

Buildings & sites 2 to 5%

Machinery & equipment 10 to 20%

Fixtures & office equipment 10 to 34%

Notes to the Financial Statements

16. Goodwill

31.12.2008

| Cost | |
|---|----------------|
| At 1 January 2008..... | 342,359 |
| Reclassification of Goodwill to deferred tax..... | (3,047) |
| Addition due to previous acquisitions..... | 2,399 |
| Exchange differences..... | (19,330) |
| At 31 December 2008..... | <u>322,381</u> |

Carrying amount

| | |
|--------------------------|----------------|
| At 31 December 2008..... | <u>322,381</u> |
| At 31 December 2007..... | <u>342,359</u> |

During the financial year, the Group assessed the recoverable amount of goodwill and determined that goodwill associated with certain of the Group's construction have not suffered an impairment loss.

16.1 Allocation of goodwill to cash-generating units

The carrying amount of goodwill was allocated to the following cash-generating units:

| | Wacc % | 2008 | 2007 |
|---------------------|---------------|----------------|----------------|
| Ossur Americas..... | 10.03 / 11.20 | 196,280 | 204,607 |
| Ossur Europe..... | 11.01 / 12.33 | 25,241 | 31,632 |
| Gibaud..... | 11.03 / 12.33 | 98,283 | 103,235 |
| Ossur Asia..... | 11.33 / 12.70 | <u>2,577</u> | <u>2,885</u> |
| | | <u>322,381</u> | <u>342,359</u> |

The recoverable amount of the cash-generating units is determined based on a value in use calculation which uses cash flow projections based on financial budgets for 2009 approved by the directors and the company's five-year strategy plan. The discount rate of 10.0 - 11.3% (2007: 11.20-12.70%) per annum was used.

Cash flows beyond that five year period have been extrapolated using a steady 3% per annum growth rate. This growth rate does not exceed the long-term average growth rate for the market in each market area. The directors believe that any reasonably further change in the key assumptions on which recoverable amount is based would not cause the carrying amount to exceed its recoverable amount.

Notes to the Financial Statements

17. Other intangible assets

| | Cust./distrib. relationship | Patent | Trademark | Other | Total |
|---------------------------|--------------------------------|--------|-----------|--------|---------|
| Cost | | | | | |
| At 1 January 2008..... | 29,731 | 16,615 | 36,307 | 16,784 | 99,437 |
| Exchange differences..... | (1,496) | (758) | (1,564) | 0 | (3,818) |
| At 31 December 2008..... | 28,235 | 15,857 | 34,743 | 16,784 | 95,619 |

Amortization

| | | | | | |
|---------------------------|--------|--------|-------|--------|---------|
| At 1 January 2008..... | 14,097 | 8,451 | 5,568 | 9,524 | 37,640 |
| Charge for the year..... | 8,828 | 2,362 | 1,125 | 2,440 | 14,755 |
| Exchange differences..... | (916) | (565) | (470) | 0 | (1,951) |
| At 31 December 2008..... | 22,009 | 10,248 | 6,223 | 11,964 | 50,444 |

Carrying Amount

| | | | | | |
|--------------------------|--------|-------|--------|-------|--------|
| At 31 December 2008..... | 6,226 | 5,609 | 28,520 | 4,820 | 45,175 |
| At 31 December 2007..... | 15,634 | 8,164 | 30,739 | 7,260 | 61,797 |

Amortization classified by operational category, is shown in the following schedule:

| | 2008 | 2007 |
|--|--------|--------|
| Cost of goods sold..... | 70 | 456 |
| Sales and marketing expenses..... | 7,778 | 7,258 |
| Research and development expenses..... | 4,091 | 4,418 |
| General and administrative expenses..... | 2,816 | 3,515 |
| | 14,755 | 15,647 |

The intangible assets included above have finite useful lives, over which the assets are amortized.

These intangible assets will be amortized on a straight line basis over their useful lives. The amortization charge for each year is recognised as expense on the following bases:

Customer and distribution relationship 20 to 30%

Patent 2 to 20%

Trademark 3 to 35%

Other 10 to 35%

Notes to the Financial Statements

18. The Consolidation

| Name of subsidiary | Place of registration and operation | Ownership % | Principal activity |
|---|-------------------------------------|-------------|--|
| Ossur Holding, AB..... | Sweden | 100% | Holding |
| Ossur Nordic, AB..... | Sweden | 100% | Sales, distribution and services |
| Ossur Nordic, AS..... | Norway | 100% | Sales, distribution and services |
| Empower H. C. Solution, AB..... | Sweden | 100% | No operation |
| Ossur Americas Holdings, Inc..... | USA | 100% | Holding |
| Ossur Americas, Inc..... | USA | 100% | Manufacturer, sales, distribution and services |
| Empower Business Sol., Inc..... | USA | 100% | No operation |
| Empower Business Solutions, Inc..... | USA | 100% | Services |
| Ossur Funding LLC..... | USA | 100% | Holding |
| Ossur Canada, Inc..... | Canada | 100% | Manufacturer, sales, distribution and services |
| Ossur Europe, BV..... | Netherlands | 100% | Sales, distribution and services |
| Ossur UK, Holdings, Ltd..... | UK | 100% | Holding |
| IMP Holdings, Ltd..... | UK | 100% | Holding |
| Ossur UK, Ltd..... | UK | 100% | Sales, distribution and services |
| TIM Holdings, Ltd..... | UK | 100% | Holding |
| TIM, Ltd..... | UK | 100% | Distribution and services |
| IMP, Ltd..... | UK | 100% | R&D and manufacturer |
| Ortex, Ltd..... | UK | 100% | Manufacturer |
| Ossur Holding France (SAS)..... | France | 100% | Holding |
| Gibaud Pharma (EURL)..... | France | 100% | Immaterial Operations |
| Gibaud (SAS)..... | France | 100% | Manufacturer, sales, distribution and services |
| Derby Finances (SAS)..... | France | 50% | Manufacturer |
| Tournier Bottu (SAS)..... | France | 100% | Manufacturer |
| Gibaud Espania (SA)..... | Spain | 100% | Sales, distribution and services |
| Gibaud Suisse (SA)..... | Swiss | 100% | Sales, distribution and services |
| Ossur Asia Pacific PTY, Ltd..... | Australia | 100% | Sales, distribution and services |
| Ossur Prosth. & Rehabilit. Co, Ltd..... | China | 100% | Manufacturer, sales, distribution and services |
| Gentleheal ehf..... | Iceland | 100% | No operation |

Ossur hf. operates a finance branch in Switzerland to govern intercompany long-term liabilities.

A new company Ossur Holding LCC was established. It is a holding entity whose sole purpose is to maintain bank relations in America.

Notes to the Financial Statements

19. Financial assets (liabilities)

| | Current | | Non-current | |
|--|------------|------------|-------------|------------|
| | 31.12.2008 | 31.12.2007 | 31.12.2008 | 31.12.2007 |
| Derivatives designated and effective as hedging instruments carried at fair value | | | | |
| Interest rate swaps..... | 0 | 0 | (9,474) | 552 |
| Financial assets carried at fair value through profit or loss (FVTPL) | | | | |
| Non-derivative financial assets..... | 0 | 0 | 1,156 | 1,283 |
| Held for trading non-derivative financial assets..... | 203 | 713 | 0 | 0 |
| | 203 | 713 | 1,156 | 1,283 |
| | 203 | 713 | (8,318) | 1,835 |

20. Bank balances and cash

| | 31.12.2008 | 31.12.2007 |
|--------------------------------------|------------|------------|
| Bank accounts..... | 27,836 | 12,738 |
| Bankers draft received..... | 2,840 | 2,945 |
| Cash and other cash equivalents..... | 230 | 206 |
| | 30,906 | 15,889 |

21. Inventories

| | 31.12.2008 | 31.12.2007 |
|-----------------------|------------|------------|
| Raw material..... | 16,756 | 18,151 |
| Work in progress..... | 5,191 | 4,497 |
| Finished goods | 33,871 | 31,629 |
| | 55,818 | 54,277 |

In the preparation of the Consolidated Financial Statements, accumulated gains in inventories from intercompany transactions amounting to USD 10,194 thousand (2007: USD 10,858) were eliminated. This has an effect on the income tax expense of the consolidated companies, and an adjustment of USD 2,639 thousand (2007: USD 2,835) is made in the Consolidated Financial Statements to reduce income tax expense to account for this.

The cost of inventories recognised as an expense includes USD 2,293 thousands in respect of write-downs of inventory to net realisable value. Reserve for obsolete inventories at year end is USD 3,129 (2007: 2,717) thousands and has been increased by USD 412 thousands during the year.

Notes to the Financial Statements

22. Accounts and other receivables

| | 31.12.2008 | 31.12.2007 |
|---------------------------------------|---------------|---------------|
| Nominal value..... | 47,552 | 51,915 |
| Allowances for doubtful accounts..... | (3,016) | (3,794) |
| Allowances for sales return..... | (715) | (716) |
| | <u>43,821</u> | <u>47,405</u> |

The average credit period on sales of goods is 49 days (2007: 55 days). Allowance has been made for doubtful accounts and sales returns, this allowance has been determined by management in reference to past default experience. The directors consider that the carrying amount of receivables approximates their fair value.

Aging of accounts receivables

| | 31.12.2008 | 31.12.2007 |
|-------------------------|---------------|---------------|
| 0 - 90 days..... | 41,269 | 45,041 |
| Older than 90 days..... | 6,283 | 6,874 |
| | <u>47,552</u> | <u>51,915</u> |

Movement in the allowance for doubtful accounts

| | 2008 | 2007 |
|--|----------------|----------------|
| At 1 January..... | (3,797) | (1,162) |
| Impairment losses recognised on receivables..... | (1,004) | (2,781) |
| Amounts written off as uncollectible..... | 1,542 | 208 |
| Exchange rate difference..... | 243 | (59) |
| At 31 December..... | <u>(3,016)</u> | <u>(3,794)</u> |

In determining the recoverability of an accounts receivable, the Company considers any change in the credit quality of the accounts receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and unrelated. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Other receivables

| | 31.12.2008 | 31.12.2007 |
|-----------------------|--------------|---------------|
| VAT refundable..... | 865 | 1,228 |
| Prepaid expenses..... | 5,497 | 5,257 |
| Other..... | 3,466 | 4,221 |
| | <u>9,828</u> | <u>10,706</u> |

Notes to the Financial Statements

23. Issued capital

Common stock is as follows in millions of shares and USD thousands:

| | Shares | Nominal value |
|--------------------------------------|--------|---------------|
| Total share capital at year-end..... | 423 | 4,821 |

Shares issued and outstanding at year-end totaled of 423,000,000. The nominal value of each share is one Icelandic krona.

Changes in share capital are as follows:

| | Share capital | Share premium | Issued capital |
|--------------------------------------|---------------|---------------|----------------|
| Balance at 1 January 2007..... | 4,170 | 103,383 | 107,553 |
| Issue of ordinary shares..... | 651 | 65,093 | 65,744 |
| Share capital at 1 January 2008..... | 4,821 | 168,477 | 173,298 |
| Cost due to increasing capital..... | 0 | (396) | (396) |
| Balance at 31 December 2008..... | 4,821 | 168,081 | 172,902 |

24. Reserves

| | Statutory reserve | Hedging reserve | Share option reserve | Translation reserve | Total reserves |
|--|-------------------|-----------------|----------------------|---------------------|----------------|
| Balance at 1 January 2007..... | 1,043 | 0 | 0 | 7,947 | 8,990 |
| Gain on cash flow hedges..... | | 552 | | | 552 |
| Share option charge for the year..... | | | 332 | | 332 |
| Loss on hedge of a net investment..... | | | | (10,599) | (10,599) |
| Transl. diff. of foreign operations..... | | | | 25,031 | 25,031 |
| Balance at 1 January 2008..... | 1,043 | 552 | 332 | 22,379 | 24,307 |
| Loss on cash flow hedges..... | | (8,605) | | | (8,605) |
| Share option charge for the year..... | | | 657 | | 657 |
| Transferred to statutory reserves..... | 162 | | | | 162 |
| Loss on hedge of a net investment..... | | | | 1,252 | 1,252 |
| Transl. diff. of foreign operations..... | | | | (22,030) | (22,030) |
| Balance at 31 December 2008..... | 1,205 | (8,053) | 989 | 1,601 | (4,257) |

Exchange differences relating to the translation from the functional currencies of the Company's foreign subsidiaries into currency units are brought to account by entries made directly to the foreign currency translation reserve. Gains and losses on hedging instruments that are designated as hedges on net investments in foreign operations are included in the translation reserve.

25. Retained earnings

| | Retained earnings |
|--|-------------------|
| At 1 January 2007..... | 45,096 |
| Net profit..... | 7,580 |
| At 1 January 2008..... | 52,677 |
| Transferred to statutory reserves..... | (162) |
| Net profit..... | 28,488 |
| At 31 December 2008..... | 81,003 |

Notes to the Financial Statements

26. Stock option contracts and obligations to increase share capital

At the annual meeting at 22 February 2008 it was agreed to grant managers of the Company, at the Board's discretion, share options agreements. The maximum number of shares to be allocated is 5,000,000 or 1.18% of the Company's current outstanding stock capital. At Balance sheet date option agreements for 2,450,000 shares have been granted to managers. These options will vest during 2012. The weighted average contract rate is ISK 91.15 per share, estimated costs due to the stock option contracts are USD 1.4 million which will be expensed over the next four years. An expense of USD 0.3 million is recognised in the Income Statement for the year.

At the annual meeting it was also agreed to change the strike price of previously issued stock option agreements granted to the CEO and the six members of the Executive Committee from 113.4 to 92.3. The total number of shares to be provided was 3,098,000. Due to changes in the Executive Committee in June the total number of shares rose to 3,290,000 or 0.77% of the Company's current outstanding stock capital. These options will vest during the month of December 2011 and July 2012. Estimated cost due to the stock option contracts are USD 2.0 million which will be expensed over the next four years. An expense of USD 0.4 million is recognised in the Income Statement for the year.

| | Number | Grant date | Expiry date | Exercise price | Fair value at grant date |
|-------------------------------|-----------|------------|-------------|----------------|--------------------------|
| Issued 5 February 2007 | 1,540,000 | 05.02.07 | 01.12.11 | 92.3 | 109.5 |
| Issued 8 February 2007 | 1,250,000 | 05.02.07 | 01.12.11 | 92.3 | 109.0 |
| Issued 23 February 2008 | 2,450,000 | 23.02.08 | 23.02.12 | 91.2 | 93.1 |
| Issued 15 July 2008 | 500,000 | 15.07.08 | 15.07.12 | 90.9 | 95.8 |

The employee must remain continuously employed with Ossur until expiring date, either as an employee or in any other way, deemed satisfactory by the Company.

| | 2008 | | 2007 | |
|---|---------------------------------|---|---------------------------------|---|
| | Number of shares (in Thousands) | Weighted average contract rate (in ISK) | Number of shares (in Thousands) | Weighted average contract rate (in ISK) |
| Outstanding at beginning of year | 3,098 | 92.30 | 3,098 | 113.40 |
| Granted during the year | 3,150 | 91.15 | 0 | 0.00 |
| Forfeited during the year | (508) | 91.90 | 0 | 0.00 |
| Outstanding at the end of the year..... | 5,740 | 91.70 | 3,098 | 113.40 |

Notes to the Financial Statements

27. Borrowings

| Secured - at amortized cost | Current | | Non - current | |
|-----------------------------|------------|------------|---------------|------------|
| | 31.12.2008 | 31.12.2007 | 31.12.2008 | 31.12.2007 |
| Loans in USD..... | 13,630 | 9,889 | 116,339 | 130,218 |
| Loans in EUR..... | 7,172 | 5,878 | 66,736 | 77,099 |
| Other borrowings..... | 32 | 307 | 42 | 100 |
| Bank overdrafts..... | 7,583 | 1,444 | 0 | 0 |
| Bridge loan in EUR..... | 53,653 | 74,060 | 0 | 0 |
| At end of year..... | 82,070 | 91,578 | 183,117 | 207,417 |

Aggregated annual maturities of long term loans are as follows:

| | | |
|---------------------|---------|---------|
| In 2009 / 2008..... | 20,834 | 16,074 |
| In 2010 / 2009..... | 20,886 | 21,236 |
| In 2011 / 2010..... | 75,604 | 21,203 |
| In 2012 / 2011..... | 86,627 | 76,576 |
| In 2013 / 2012..... | 0 | 88,202 |
| | 203,951 | 223,291 |

Summary of borrowing arrangements

The Company's major credit facility was entered into in 2005. The term loan facility was originally in the amount of USD 200 million and was increased by USD 40 million in 2006 and USD 15.5 million in 2007 to finance acquisitions. The term loan consists of an amortizing loan maturing in 2010 and bullet loans amortizing in 2011 and 2012. Approximately 64% of the total term loan is in USD and 36% in EUR.

In December 2006 the Company entered into a EUR 100 million bridge loan facility agreement to finance the acquisition of the Gibaud Group (La Tour Finance) in France. Proceeds from the Company's equity offering in November 2007 as well as excess cash were used to partially repay the bridge loan facility in the fourth quarter of 2007. The outstanding amount including interests of EUR 38.2 million (USD 53.7) is included in the Company's current liabilities at the end of the year.

From July 1st 2007, the bridge loan is acknowledged as a hedge against the net investments in Gibaud Group. Any gain or loss from the hedging instrument relating to the effective portion of the hedge is recognised in the hedging reserve within the Company's equity.

The terms of the loan facilities include various provisions that limit certain actions by the Company without prior consulting with the lender. In addition, the loan facilities include certain financial covenants. The Company has pledged certain assets, including buildings, machinery, equipment and inventories to secure banking facilities granted.

The average interest rate in 2008 was 5.95% (2007: 6.07%).

Debt issuance cost has been capitalized and is amortized over the term of the loan. The remaining amount is USD 1.7 million at year end.

Notes to the Financial Statements

28. Deferred tax asset / (liability)

| | 31.12.2008 | 31.12.2007 |
|--|---------------|---------------|
| At 1 January..... | 34,266 | 30,281 |
| Calculated tax for the year..... | (9,745) | (473) |
| Arising on acquisition of a subsidiary..... | 0 | (879) |
| Reclassification of goodwill to tax asset..... | 3,047 | 0 |
| Recognised directly through equity..... | 1,191 | 0 |
| Income tax payable for the year..... | 376 | 5,548 |
| Exchange differences..... | 5,352 | (211) |
| At 31 December..... | <u>34,487</u> | <u>34,266</u> |

The following are the major deferred tax liabilities and assets recognised:

| | Assets | Liabilities | Net |
|---|---------------|-----------------|---------------|
| Goodwill..... | 47,471 | 0 | 47,471 |
| Intangible assets..... | 0 | (27,076) | (27,076) |
| Operating fixed assets..... | 1,367 | (518) | 849 |
| Tax loss carry forward..... | 4,771 | 0 | 4,771 |
| Inventories..... | 3,287 | 0 | 3,287 |
| Provisions..... | 2,183 | 0 | 2,183 |
| Current liabilities..... | 1,875 | 0 | 1,875 |
| Other..... | 1,375 | (248) | 1,127 |
| Total tax assets/ (liabilities)..... | <u>62,329</u> | <u>(27,842)</u> | <u>34,487</u> |
| Tax asset and liabilities offsetting..... | <u>(766)</u> | <u>766</u> | <u>0</u> |
| Total..... | <u>61,563</u> | <u>(27,076)</u> | <u>34,487</u> |

Deferred tax assets / liabilities as shown in the balance sheet as:

| | | |
|---|---------------|-----------------|
| Non Current deferred tax asset / (liabilities)..... | 56,407 | (25,870) |
| Current deferred tax asset / (liabilities)..... | 5,156 | (1,206) |
| | <u>61,563</u> | <u>(27,076)</u> |

Notes to the Financial Statements

29. Provisions

| | Current | | Non-current | |
|-------------------------|--------------|--------------|--------------|--------------|
| | 31.12.2008 | 31.12.2007 | 31.12.2008 | 31.12.2007 |
| Warranty (i)..... | 3,835 | 1,847 | 2,704 | 2,347 |
| Restructuring (ii)..... | 3,017 | 3,788 | 0 | 0 |
| Other..... | 807 | 1,288 | 871 | 771 |
| | <u>7,659</u> | <u>6,923</u> | <u>3,575</u> | <u>3,118</u> |

(i) The warranty provision represents management's best estimate of the Company's liability under warranties granted on prosthetics products, based on past experience and industry averages for defective products.

(ii) The restructuring provision is related to the acquisition of Gibaud in December 2006.

| | Warranty provisions | Restructuring provisions | Other provisions | Total |
|--------------------------------------|---------------------|--------------------------|------------------|---------------|
| At 1 January 2008..... | 4,194 | 3,788 | 2,059 | 10,041 |
| Additional provision recognised..... | 4,225 | 0 | (238) | 3,987 |
| Utilization of provision..... | (1,880) | (604) | 0 | (2,484) |
| Exchange differences..... | 0 | (167) | (143) | (310) |
| At 31 December 2008..... | <u>6,539</u> | <u>3,017</u> | <u>1,678</u> | <u>11,234</u> |

30. Other liabilities

| | 31.12.2008 | 31.12.2007 |
|--|---------------|---------------|
| Accrued expenses..... | 7,279 | 6,019 |
| Accrued salaries and related expenses..... | 12,928 | 14,239 |
| Royalties..... | 1,334 | 1,296 |
| Sales tax and V.a.t. | 429 | 2,399 |
| Payable due to previous acquisition..... | 2,324 | 0 |
| Other..... | <u>1,839</u> | <u>3,131</u> |
| | <u>26,132</u> | <u>27,084</u> |

Notes to the Financial Statements

31. Financial instruments

31.1 Capital risk management

The Company manages its capital to ensure that entities in the Company will be able to continue as a going concern while maximizing the return to stakeholders through the optimisation of the debt and equity balance. The Company's overall strategy remains unchanged from the previous year.

The capital structure of the Company consists of debt, which includes the borrowings disclosed in note 27, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in notes 23, 24 and 25 respectively.

Equity ratio

The Company's management continuously reviews the capital structure. As part of this review, the management considers the cost of capital. The Company has a target equity ratio of minimum 30% determined as the proportion of equity to total assets.

The equity ratio at the year end was as follows:

| | 31.12.2008 | 31.12.2007 |
|--------------------|------------|------------|
| Equity | 249,648 | 250,282 |
| Total assets | 603,778 | 635,821 |
| Equity ratio..... | 41.3% | 39.4% |

31.2 Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 3 to the Financial Statements.

31.3 Financial risk management objectives

The Company's Corporate finance function provides services to the business, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Company through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

The Company seeks to minimise the effects of these risks by using derivative financial instruments to hedge these risk exposures. The use of financial derivatives is governed by the Company's policies approved by the board of directors, which provide written principles on foreign exchange risk, interest rate risk, credit risk, the use of financial derivatives and non-derivative financial instruments, and the investment of excess liquidity. The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Notes to the Financial Statements

31.4 Foreign currency risk management

The Company operates on a global market hence exposure to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters. The general policy is to apply natural exchange rate hedging to the extent possible but the Company also utilizes forward foreign exchange contracts.

The carrying amounts of the Company's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

| | Liabilities | | Assets | |
|-------------|----------------|----------------|----------------|----------------|
| | 31.12.2008 | 31.12.2007 | 31.12.2008 | 31.12.2007 |
| USD | 156,000 | 152,462 | 67,498 | 58,188 |
| EUR | 151,193 | 174,612 | 55,936 | 50,268 |
| GBP | 1,169 | 3,831 | 8,046 | 8,414 |
| SEK | 2,196 | 3,608 | 5,370 | 8,484 |
| CAD | 358 | 1,285 | 2,296 | 3,207 |
| Other | 4,905 | 9,096 | 2,587 | 2,264 |
| | 315,820 | 344,894 | 141,732 | 130,825 |

Foreign currency sensitivity analysis

The Company is mainly exposed to the currency of Iceland (ISK) and the European Union (EUR).

The following table details the Company's sensitivity to a 10% decrease in USD against the relevant foreign currencies with all other variables fixed. The sensitivity analysis includes all foreign currency denominated items and adjusts their translation at the year end for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where USD weakens 10% against the relevant currency. For a 10% strengthening of USD against the relevant currency, there would be an equal and opposite impact on the profit and other equity, and the balances below would be negative.

| | EUR | | ISK | | |
|----------------------|------|-------|-------|--------------|---------|
| | 2008 | 2007 | 2008 | 2007 | |
| Profit or loss | (i) | 2,549 | 1,534 | (ii) (2,952) | (2,939) |
| Other equity | | 6,264 | 3,654 | (287) | (400) |

(i) 28% (2007: 26%) of the Company's cost is in EUR against 32% (2007: 30%) of its total income causing an increase in profit if the USD decreases against the EUR.

(ii) This is attributable to the fact that approximately 10% (same in 2007) of the Company's operating cost is in ISK against 0.5% (1% in 2007) of its income.

Notes to the Financial Statements

Forward foreign exchange contracts

The Company is exposed to interest rate risk as funds are mainly borrowed at floating interest rates. Interest rate risk is managed by the Corporate Finance function by maintaining an appropriate mix between fixed and floating rate borrowings, by the use of interest rate swap contracts. Hedging activities are evaluated regularly to align with interest rate views and defined risk appetite; ensuring optimal hedging strategies are applied.

31.5 Interest rate risk management

The Company is exposed to interest rate risk as funds are mainly borrowed at floating interest rates. Interest rate risk is managed by the Corporate Finance function by maintaining an appropriate mix between fixed and floating rate borrowings, by the use of interest rate swap contracts. Hedging activities are evaluated regularly to align with interest rate views and defined risk appetite; ensuring optimal hedging strategies are applied.

The Company's exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section of this note.

Contracts with nominal values of USD 140 million and EUR 48.6 million have been made to swap floating interest rates to fixed with an average weighted interest rate of 4.34% for periods up to 2012. The fair value of interest rate swaps at the reporting date is determined by discounting the future cash flows using the curves at reporting date and the credit risk inherent in the contract, and is disclosed below. The average interest rate is based on the outstanding balances at the start of the financial year.

Outstanding interest rate swap contracts (cash flow hedge) at 31 December 2008 are due over the next four years. The contracts' fair value is negative USD 9.5 million and principal amount USD 167 million.

The Company's Interest Rate Swap Agreements were made with Kaupthing Bank hf. (the "Bank") in November 2005. On the 9th of October 2008, the Icelandic Financial Supervisory Authority (the "FSA") used powers granted by the Icelandic Parliament, with reference to Act No. 161/2002, to take control of the Bank by assuming the powers of a meeting of shareholders and appointing a Resolution Committee. On the 21st of October 2008, FSA decided to transfer a substantial part of the Bank's assets and operations to a new bank, New Kaupthing Bank hf. (the "New Bank"). The New Bank was formed and is fully owned by the Icelandic Government. The transfer of assets from the Bank to the New Bank included all Ossur's long term loan agreements. However, as a general rule, no derivative contracts were transferred from the Bank to the New Bank, including Ossur's Interest Rate Swap Agreements. On 24th of November 2008, the District Court of Reykjavik granted the Bank a moratorium. The final treatment of Ossur's Interest Rate Swap Agreements at the Bank is therefore subject to uncertainty.

Notes to the Financial Statements

31.6 Liquidity risk management

The Company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. At year end the Company had undrawn revolving credit facilities at its disposal amounting to USD 827 thousand to further reduce liquidity risk.

The following tables detail the Company's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to pay. The table includes both interest and principal cash flows.

| | Weighted average effective interest | Less than 1 year | 1-5 years | 5+ years | Total |
|--|--|---------------------|-----------|----------|---------|
| 2008 | | | | | |
| Borrowings | 5.95% | 97,882 | 208,769 | 0 | 306,651 |
| Non-interest bearing liabilities | - | 41,159 | 0 | 0 | 41,159 |
| | | 139,041 | 208,769 | 0 | 347,810 |
| 2007 | | | | | |
| Borrowings | 6.07% | 109,721 | 198,244 | 54,676 | 362,641 |
| Non-interest bearing liabilities | - | 45,899 | 0 | 0 | 45,899 |
| | | 155,620 | 198,244 | 54,676 | 408,540 |

32. Operating lease arrangements

Payments recognised as an expense:

| | 2008 | 2007 |
|---|------------|------------|
| Minimum lease payments..... | 7,641 | 7,645 |
| Non-cancellable operating lease commitments | | |
| | 31.12.2008 | 31.12.2007 |
| Not longer than 1 year..... | 5,964 | 7,838 |
| Longer than 1 year and not longer than 5 years..... | 16,691 | 20,418 |
| Longer than 5 years..... | 7,735 | 15,760 |
| | 30,390 | 44,016 |

Operating lease payments represent rentals payable by the consolidation for certain of its office properties and cars. Thirty-five rental agreements are in place for premises in Reykjavik, Netherlands, Germany, Canada, Australia, Sweden, United Kingdom, China and the United States. The leases expire in the years 2009-2017.

Notes to the Financial Statements

33. Litigation

On 5 December 2006, Ossur hf., parent company of Ossur North America Inc. and Royce Medical Inc., Ossur America's predecessor companies, disclosed to the Office of Inspector General of the U.S. Department of Defense that Ossur North America, Inc. and Royce Medical Company may have made some sales to the government that were not consistent with the requirements of the Buy American Act or Trade Agreements Act. A review was conducted by third party experts of the sales and the circumstances surrounding the sales. The review's conclusions were sent in a report to the Inspector General of the Department of Defense in the last quarter of 2007. The likely outcome of this matter remains uncertain.

34. Insurance

| | Insurance value | Book value |
|------------------------------------|--------------------|---------------|
| Fixed assets and inventories | 146,344 | 98,936 |

The consolidation has purchased a business interruption insurance intended to compensate for temporary breakdown of operations. The insurance amount is USD 276 million. In addition the consolidation has a product & professional liability insurance with a USD 30 million limit and a product recall insurance with a USD 2 million limit. The deductible amount on the product & professional liability and product recall insurances is USD 50 thousand.

35. Events after the Balance Sheet date

On January 28th 2009 New Kaupthing Bank hf. approved to refinance the bridge loan facility with the outstanding amount of EUR 37.4 million at December 31st 2008, by increasing the amount within previous long term loan facilities. The new loan facilities have not been finalised.

36. Approval of the Consolidated Financial Statements

The Consolidated Financial Statements were approved by the board of directors and authorised for issue on February 4th 2009.

Unaudited Information

The following notes are not audited as they relate to quarterly information and the Company only requires an audit for the full year.

a) Quarterly statements

| | Q1 2008 | Q2 2008 | Q3 2008 | Q4 2008 | Total 2008 |
|---|---------------|---------------|---------------|---------------|----------------|
| Net sales | 89,754 | 92,881 | 87,264 | 80,118 | 350,017 |
| Cost of goods sold | (36,577) | (38,634) | (35,499) | (32,953) | (143,663) |
| Gross profit | 53,177 | 54,247 | 51,765 | 47,165 | 206,354 |
| Other income | 5,739 | 1,264 | 2,479 | (49) | 9,433 |
| Sales and marketing expenses | (23,499) | (23,388) | (22,059) | (21,017) | (89,963) |
| Research and development expenses | (5,424) | (5,379) | (5,100) | (5,027) | (20,930) |
| General and administrative expenses | (12,952) | (14,000) | (11,727) | (10,257) | (48,936) |
| Profit from operations | 17,041 | 12,744 | 15,358 | 10,815 | 55,958 |
| Financial income | 93 | 105 | 27 | 639 | 864 |
| Financial expenses | (9,136) | (5,200) | 2,355 | (6,608) | (18,589) |
| Profit before tax | 7,998 | 7,649 | 17,740 | 4,846 | 38,233 |
| Income tax | (1,314) | (3,705) | (4,051) | (675) | (9,745) |
| Net profit | 6,684 | 3,944 | 13,689 | 4,171 | 28,488 |

Ossur's subsidiary Gibaud implemented the Company's accounting policies at the start of the current year, adjustments have been made to Gibaud's 2007 Income Statement accordingly. The effects on the Consolidation in 2007 are reclassifications between expenses in the Income Statement amounting to USD 6.8 million in cost of goods sold and the same amount decreases operating expenses. This reclassification has no effect on the Company's operational profit or net result in 2007.

b) Q4 Earnings per share

The calculation of Earnings per Share is based on the following data:

| | Q4 | Q4 |
|---|---------|---------|
| Net profit Q4..... | 4,171 | 6,648 |
| Total average number of shares outstanding during Q4 (in thousands)..... | 422,982 | 391,405 |
| Total average number of shares including potential shares (in thousands)..... | 422,906 | 391,295 |
| Basic Earnings per Share (US cent) | 0.99 | 1.70 |
| Diluted Earnings per Share (US cent) | 0.99 | 1.70 |
| Cash Earnings per Share | 2.29 | 3.38 |
| Diluted Cash Earnings per Share | 2.29 | 3.38 |

Unaudited Information

c) Reclassification of 2009 comparative figures

In 2009 all income and expenses related to freight to customers will be classified as sales and marketing expenses. This will affect the 2008 comparative figures in the 2009 financial reports. The total reclassification from net sales and cost of goods sold can be seen in the table below. This reclassification has no effect on the Company's operational profit or net result.

2008 reclassification of freight

| | Total | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|--------------|--------------|--------------|--------------|--------------|
| Net sales | (3,182) | (678) | (794) | (826) | (884) |
| Cost of goods sold | 11,031 | 2,524 | 2,738 | 2,978 | 2,791 |
| Gross profit | 7,849 | 1,846 | 1,944 | 2,152 | 1,907 |
| Other income | 0 | 0 | 0 | 0 | 0 |
| Sales and marketing expenses | (7,849) | (1,846) | (1,944) | (2,152) | (1,907) |
| Research and development expenses | 0 | 0 | 0 | 0 | 0 |
| General and administrative expenses | 0 | 0 | 0 | 0 | 0 |
| Profit from operations | 0 | 0 | 0 | 0 | 0 |

2008 with reclassification of freight

| | Total | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|----------------|---------------|---------------|---------------|---------------|
| Net sales | 346,835 | 79,440 | 86,470 | 92,055 | 88,870 |
| Cost of goods sold | (132,632) | (30,429) | (32,761) | (35,656) | (33,786) |
| Gross profit | 214,203 | 49,011 | 53,709 | 56,399 | 55,084 |
| Other income | 9,433 | (49) | 2,479 | 1,264 | 5,739 |
| Sales and marketing expenses | (97,812) | (22,863) | (24,003) | (25,540) | (25,406) |
| Research and development expenses | (20,930) | (5,027) | (5,100) | (5,379) | (5,424) |
| General and administrative expenses | (48,936) | (10,257) | (11,727) | (14,000) | (12,952) |
| Profit from operations | 55,958 | 10,815 | 15,358 | 12,744 | 17,041 |