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GN Store Nord
A World of Communications

Chairman's report, GN Store Nord Annual General Meeting, April 3, 2003

Please find enclosed the Chairman's Report submitted to the GN Store Nord Annual General Meeting held on April 3, 2003.

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About GN Store Nord
GN Store Nord helped people connect since 1869. Initially, as a telegraph company and now as a global market leader in personal communications providing increased mobility and quality of life for our customers. GN Store Nord develops and manufactures headsets for hands-free communication, hearing instruments and audiologic diagnostics equipment. GN Store Nord products are marketed globally.

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Introduction

In several ways, 2002 was an encouraging year for GN Store Nord. Although the economic situation was unfavorable for us, we managed to improve our earnings substantially in continuing GN operations in headsets, hearing instruments and audiologic diagnostics equipment. We launched innovative new products, generally retaining our market shares and even lifting our shares of vital markets. We made great progress in the comprehensive restructuring of our business that is so essential if we are to generate acceptable earnings in GN in the years ahead.

Unfortunately, all our progress is being overshadowed by events in NetTest. As the year progressed, demand on NetTest's markets suffered another severe setback, and in December we divested NetTest at a price that was definitely not satisfactory, but it was the best we could get.

Overall, NetTest had a negative impact for the year of DKK 5.2 billion before tax, and that is the reason I am reporting to you today that GN suffered a loss before tax of about DKK 5.3 billion. This performance is absolutely unsatisfactory, and the figure is much lower than we expected at the start of the year.

Strategy

We began the project of spinning off NetTest in the late autumn months of 2000: there were no industrial synergies between headsets and hearing instruments on the one hand and NetTest's test equipment for the communications industry on the other. We also wanted to eliminate the conglomerate discount that would continue to depress our share price as long as GN continued to own NetTest.

Our first step was to provide NetTest with the manpower that would enable the company to stand on its own two feet. Then we began the preparations to list the company, but this plan was foiled by the sudden, severe erosion of demand on NetTest's markets in the spring of 2001. During 2001, the financial markets were also hit by a severe setback, and both the stock markets and NetTest's commercial markets suffered unexpected further deterioration last year.

As a result, in 2002, we had to give up all plans of an independent listing as well as the subsequent plan of a tax-free demerger of GN Store Nord that would have seen NetTest spun off as an independently listed company owned by the shareholders of GN Store Nord.

At the same time, due to a constant decline in demand, especially for NetTest's fiber optic products, we had to take action by also letting a lot of our employees go in 2002 and recognizing substantial impairment losses on goodwill, inventories and development projects in NetTest. Impairment losses totaled DKK 3.8 billion, and NetTest's substantial operating loss (EBITA) of more than DKK 1.6 billion is the reason why we are reporting a highly unsatisfactory consolidated loss for 2002 to you today.

During the late summer months of 2002, we opened negotiations to sell NetTest, and as you know, we divested the company effective December 31.

The price we obtained is certainly not impressive by any means, but I can promise you that it was the best we could get at the time. Your Board felt that it was unacceptable for GN to continue operating in the shadow of uncertainty that NetTest was casting on the Group's other future operations, which is why divesting the company was the right thing to do.

All effects of the sale of NetTest have been recognized in the annual report for 2002. As part of the transaction, we are committed to paying net costs of up to DKK 150 million with an expected cash effect in the years ahead. Most of these costs would be incurred in 2003, but it is important to note that we would probably have had to incur even greater costs, had we retained ownership of the company.

As mentioned at last year's Annual General Meeting, GN's four existing business areas were strengthened considerably through a large number of acquisitions made in the years before the economic slump began in 2001. In all of our business areas, we gained a position among the industry leaders.

In the last couple of years, we've been focused on integrating the many acquisitions and adapting to the significant changes in market conditions, and that will also be our main objective over the next few years.

The further growth of GN will not rely on major acquisitions in coming years, and we are confident that the best way we can create value for our shareholders in the short term is to optimize our operations.

We aim to enhance GN's earnings over the coming years both by streamlining each of our four business areas and by capitalizing even more on the synergy potential between them. In the short term, we will target the synergies between the business areas by restructuring our organization in our treasury and finance departments, establishing shared production facilities in China and implementing projects that will to some extent standardize and capitalize on our company's consolidated buying power. In the longer term, we expect that the transfer of technology between business areas will gradually take on more and more importance.

I will come back to the performance of each individual business area in a little while, but first I would like to review the financial highlights as they are set out on page 6 of the Annual Report.

Financial review

GN Store Nord generated a revenue of DKK 5,512 million in 2002, just over DKK 1.8 billion less than in 2001. The decline was mainly due to lower sales in

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NetTest, but the fall in the US dollar and a slight setback in headset sales were also contributing factors.

EBITA for the year was highly unsatisfactory at DKK (1,204) million, which was a result of the DKK (1,580) million impact from NetTest. Activities in the rest of GN lifted earnings to DKK 376 million from DKK 302 million in 2001, but the improvement was completely overshadowed by NetTest.

Restructuring costs amounted to DKK 374 million in 2002, against DKK 393 million in 2001, whereas for GN excluding NetTest, the figure fell from DKK 192 million to DKK 162 million. NetTest's restructuring costs rose from DKK 201 million in 2001 to DKK 212 million in 2002.

Furthermore, the loss for the year before tax was strongly affected by impairments on goodwill and other intangibles totaling DKK 2,719 million and relating solely to NetTest.

This brought the loss from ordinary activities before tax to DKK 5,289 million, against DKK 9,642 million the year before. Considering this highly unsatisfactory performance for the year, the Supervisory Board recommends to the Annual General Meeting that *no* dividend be paid in respect of the financial year.

At the end of the year, the Group had total assets of DKK 7,938 million, down from DKK 15,023 million in 2001. The decline was mainly due to the sale of NetTest. As you know, we initiated the sales process in the fall, and by the end of the third quarter it became clear that NetTest's carrying values did not realistically reflect its market value. As we did in 2001, we then resolved to take a significant impairment loss, this time of DKK 3,833 million.

Shareholders' equity fell from DKK 10,708 million to DKK 4,789 million at December 31, 2002, but backed by an equity ratio of 60%, GN Store Nord remains financially strong.

Cash flows from operations were DKK 241 million in 2002, which is unsatisfactory, against DKK (65) million in 2001. Looking at GN excluding NetTest, however, we had cash flows from operations of DKK 557 million, a strong improvement from the 2001-figure of DKK 350 million. There is still room for improvement, and we intend to enhance our cash flows from operations further through a combination of stronger earnings and an even better management of our working capital

Accounting standards

As you know, GN has been presenting its financial statements in accordance with the International Financial Reporting Standards (IFRS), previously known as the IAS standards, since 1999. As the name implies, this is an internationally recognized standard, which makes it easier for international investors to read and evaluate our annual report.

GN was among the first companies in Denmark to adopt IFRS, which is set to become a statutory requirement for listed companies throughout the EU from 2005. Under the new requirements, GN and all other Danish listed companies, as well as many other international businesses, will be required to capitalize and amortize development costs that are expected to lead to future earnings and can be reliably measured and related to specific projects. The new Danish Financial Statements Act contains similar rules, which took effect from 2002.

GN incurred development costs of DKK 325 million on headsets, hearing instruments and audiologic diagnostics equipment in 2002. In our income statement, the recognized costs are stated at DKK 211 million. This figure covers DKK 325 million in development costs incurred, DKK 69 million in amortization from previously capitalized amounts, and the amount capitalized in GN for the year, excluding NetTest, of DKK 183 million, or about 56%.

Since GN adopted the IAS standards, we have capitalized more and more of our annual costs as we gradually implemented the new accounting policies. After starting at 26% in the first year, we have now reached 56%. Initially, the greater ratio served to improve our income statement, because, generally speaking, we capitalized more each year than we amortized on the amounts capitalized in prior years. In 2003, our amounts capitalized and amortized will be better balanced. GN applies IFRS to the letter in this respect and provides very detailed notes, but, in hindsight, we might have communicated the impact on our EBITA a bit more clearly. That is why we have dealt with this matter in great detail in this year's Management's Report. Previously, we only described it in the notes to the financial statements. This way, we hope to have eliminated any uncertainty about this.

The concept of EBITA is not defined in the IFRS standards, but to make it easier for investors and analysts to compare GN's financial statements with those of our foreign competitors, we have defined and applied this concept in the report. In that connection, we have been asked about the distinction between costs "above" and "below" the EBITA line. This is a very reasonable question, because for years GN has incurred substantial restructuring costs in all business areas in the wake of our many acquisitions. We have adapted our organization, restructured and cut back, and we have paid the short-term price in the form of restructuring costs. In return, we will receive long-term benefits because these initiatives will enhance our earnings. We recognize these restructuring costs under the EBITA line because they are non-recurring. If we included them with the rest of our operations, it would be impossible to show the true performance of GN's operations.

GN does not expect any restructuring costs in the income statement from 2004 onwards, unless we make new major acquisitions. The extensive changes following in the wake of the many acquisitions have either been completed in 2003 at the latest or announced during the year, which will result in provisions in the current financial year. At the same time, that will render the question of whether the item restructuring costs should be above or below the EBITA line less relevant.

I will now review the highlights of GN's current business areas in 2002 and present our expectations for "The New GN".

Hearing instruments and diagnostics equipment
The year 2002 was one of satisfactory progress for GN ReSound and its two business areas, hearing instruments and audiologic diagnostics equipment.

In spite of the difficult market conditions, the business became more profitable, thanks mainly to the rationalization measures we have implemented over the past few years and which will continue in 2003. Since 1999, we have created a major global player on the market for hearing instruments, GN ReSound, by gradually merging and integrating five medium-sized hearing instrument businesses and spending almost DKK 575 million in the process.

Our hearing instrument business is based on technological strength and innovation, and its profit margins are performing well compared with the competition, although some still make a much larger profit per revenue dollar than we do.

We closed the remaining standard production facilities in the United States and the Netherlands, relocating to our new factory in Xiamen, China. During a relatively short period of time, we've now closed down all standard production facilities in Denmark, the Netherlands, the United States and Austria and rationalized our R&D operations. Almost 1,300 jobs out of our current staff of 3,300 employees have been eliminated or relocated elsewhere on the globe, mainly to China.

In spite of the changes made, we've retained our innovative power: one of the best examples being the Canta series. The first Canta devices did not come on the market until 2001, but the series now represents almost 50% of our hearing instrument revenue and soon, catering to the needs of the most demanding users, we plan to introduce new advanced solutions in the Canta family of products.

Today, at a very important industry trade fair in San Antonio, Texas, we are introducing yet another example of our innovative power: the ReSoundAIR, a new, virtually invisible hearing instrument designed specifically for the large population of 45-60-year-olds, who find it hard to accept that they suffer from a mild hearing loss and who certainly do not want to reveal to the world that they have a hearing impairment. We expect a great deal from the ReSoundAIR device.

We manufacture both headsets and hearing instruments at Xiamen, China. Costs are low and the quality is second to none. The benefits of the relocations will truly begin to feed through during 2003, but we will not see the full effects until other parts of the GN ReSound integration are in place. GN ReSound's product assortment is still much too comprehensive, but that is because we are deliberately phasing out several brands in a slow process, so we do not lose too many customers. As you know, we lost market shares immediately after the acquisitions and during the initial years of integration, but we very much reversed the trend in 2002 thanks to the Canta family of products launched in 2001.

We have also reversed the negative trend in our Beltone network in the United States, with the number of dispensers growing constantly since the spring of 2001. This combines with the launch of Oria, our advanced digital hearing instrument, to strengthen Beltone's image and to make joining the network even more attractive for other dispensers.

We have also restructured GN Otometrics, our business involving audiologic diagnostics equipment, by concentrating production in the United States and Denmark and expanding geographical coverage using the company's own salespersons. GN Otometrics' program to rationalize its product platform is also well under way. Over the next few years, most of the products will gradually be based on the same platform of software and technology.

As I have already said, we have spent a lot of money streamlining our hearing instrument and diagnostics equipment businesses. We will also be restructuring in 2003, but not nearly to the same extent as previously. We have recently completed one of this year's restructuring projects: in March, Beltone's Brand Division relocated from Eindhoven to Copenhagen, and that will cut costs by as much as DKK 40 million per year. We expect to finalize GN ReSound's new structure by 2004.

Integrating and streamlining operations and creating a new common corporate culture the way we are doing it in GN ReSound is certainly no ordinary project, neither for GN ReSound nor for the industry in general.

That said, this has turned out to be a larger project than we had anticipated three or four years ago and it will take about 12 months longer than expected. In return, we have created a large, strong player on the market for hearing instruments, with its EBITA margin improving from 6% in the second half of 2000 to almost 11% in the second half of 2002. So, although this huge project of change has been a major investment for GN, it has been absolutely necessary for us in securing higher earnings for the years ahead.

Headsets
At the beginning of the year, GN Netcom changed its organization, moving from a geographical to a two-division structure, one working the mobile market, the other call centers and offices (CC&O).

2002 was the year when Bluetooth™ technology became a feature of headsets for cellphones. Bluetooth is a global wireless communication standard that nearly all major communication equipment manufacturers subscribe to. GN was the first to market wireless Bluetooth headsets, and today we manufacture three JABRA models, which is our own brand, and two OEM models, one for Motorola and one for Siemens. In 2002 we sold about 350,000 Bluetooth headsets.

Although our Bluetooth headsets were only on the market for eight or nine months of last year, they contributed half of our total mobile revenue of DKK 335 million. We expect that the products will lift mobile sales to about half a billion kroner this year. We have new products in the pipeline, both for OEM customers and under our own brand, and there is no doubt that Bluetooth headsets represent a big opportunity for GN; especially if JABRA gains as strong a market position in Europe as they already have in the United States, where JABRA products are sold by major retail chains and mobile carriers through about 35,000 outlets.

Sales to the CC&O market fell by approximately DKK 175 million last year to just over DKK 1.4 billion. The decline was caused mainly by the economic slump in the United States, but investments in Europe's contact centers also fell. In spite of the lower revenue and the negative impact from the US dollar, GN Netcom managed to push its operating profit up from DKK 129 million to DKK 148 million. That equals an EBITA margin of 8.5%, compared with 6.7% in 2001, much of this improvement due to the rationalization measures implemented over the past two years, including the final relocation of production facilities from Europe and the United States to China. All GN headsets are now manufactured in China, either by our own plant in Xiamen or by subcontractors.

We recently introduced the GN 9120 with its innovative design and performance on the CC&O market. We are making every effort to promote the use of headsets on the office market, emphasizing the increased employee comfort and productivity. This market also offers a substantial potential, but to be realistic, it will take a number of years to materialize.

Like GN ReSound, today's GN Netcom was created through the mergers of several headset businesses, but the process has run over a number of years and involved the acquisitions of small businesses that had to be integrated into a much larger company. This made the process a great deal easier than the process of change GN ReSound is currently implementing.

The New GN

As I have already mentioned, the sale of NetTest was the final step in GN's transition from a conglomerate to a single focused personal communication business.

Today's GN has four business areas. We have operated two headset divisions since January 1, when we split GN Netcom into a division targeting the CC&O market and a division addressing the mobile market. The new structure will facilitate the necessary focus on these very different market segments. Both the market for contact centers and, to some extent, the office market are B2B businesses in which professional customers have an extensive understanding of the technology. On the mobile market, the main characteristics determining success or failure are design, distribution and branding aimed at consumers. We are the second-largest player globally on the CC&O market, and we estimate that we hold a similar position on the mobile market. However, competition will undoubtedly increase significantly on the latter market in the years ahead, so we may have to settle for a smaller share, although that would be of a substantially larger and constantly growing market.

The two other business areas, hearing instruments and audiologic diagnostics equipment, cooperated closely on all markets. GN Otometrics is clearly the world's largest provider of audiologic diagnostics equipment; GN ReSound is among the three largest hearing instrument manufacturers. GN ReSound's market shares have been declining slightly since 2000 because we have phased out brands and products, revamped the sales organization and spent our resources on boosting earnings rather than on winning market share. As I have already mentioned, the tide turned in 2002, when GN ReSound won market shares on several markets, including the United States, thanks to our new digital products.

Today, GN operates shared manufacturing facilities in China, and product technologies are beginning to flow between our business areas. We can develop better and more user-friendly headsets using hearing instrument technology. We have developed new audiological measurement instrumentation by using the Bluetooth technology we have implemented so well in our headset products. Additionally, we are working to introduce wireless technology in hearing instruments in order to improve speech understanding and to enable hearing instruments to connect to other equipment.

Nothing is sacred in our efforts to enhance earnings. At the beginning of the year, we put the property at Kgs. Nytorv – our headquarters for more than 100 years – up for sale, and we plan to relocate to leased premises outside the city center. With the ever-growing integration of our company, having a group of employees based away from our operative units is simply not feasible. The relocation will also lead to cost savings.

We are also merging GN's treasury and finance functions, and the shared IT platform will gradually facilitate a number of necessary administrative cost cuts. During this year and the next, we will halve the costs of our joint administrative functions from DKK 100 million in 2002 to DKK 50 million in 2004.

It is only about three months old, but the new GN is already growing up fast.

Among companies incurring major losses, there are very few exceptions to the general rule that the Supervisory Board usually elects to replace the chief executive. Doing this allows a board to demonstrate its ability and determination to act when necessary, and the responsibility for the problems is effectively put onto the shoulders of one man – or woman.

While this may be a convenient solution, it is *not* GN Store Nord's solution to the major difficulties we are now leaving behind us.

There is no doubt that buying Photonetics for NetTest in 2000 was an overreaction on the part of GN Store Nord. The price we paid was much too high, given the fact that transaction prices reflect growth expectations. At the time, everyone had extremely high expectations for growth on NetTest's markets and in the telecommunications sector in general. The market back then was completely different from what it is today, but that is also the reason why we were able to sell SONOFON for DKK 14 billion and book a substantial profit in the double-digit of billions of kroner for GN Store Nord. That would not have been possible today.

No one had anticipated back then in 2000 – because no one was in a position to – that NetTest's optical markets would collapse completely the following year, and that the global economy would be hit by an extended slump that, unfortunately, still prevails.

We were wrong – thoroughly wrong. Our advisors were wrong. Our competitors, who also made very large acquisitions back then, were also wrong. And all the equity analysts, industry analysts, investors and journalists who lined up to praise GN Store Nord for the acquisition of Photonetics completely misinterpreted the situation back then.

My colleagues on the Board and I regret very much the Photonetics acquisition and it fills us with remorse and a sense of humility towards GN's shareholders. And I know that this feeling is – if at all possible – even stronger in GN Store Nord's current Executive Management, especially Jørn Kildegaard, who was second in command in 2000. However, the Board and the Executive Management both share in their misinterpretation of the situation back then, and we will not shrink away from our responsibility. We intend to see this through together.

That is the reason why we have retained the management team that is best able to create results here and now, as it already demonstrated last year and as it will certainly continue to in the future. This is a management that has a lot to give to GN and who are extremely dedicated to the assignment they have been given by the Board: to create The New GN. I would remind you that The New GN recorded healthy progress already in 2002, but unfortunately that was completely overshadowed by NetTest. Our momentum will pick up speed in 2003, as I will explain, now that we need no longer worry about NetTest. We have a foundation for even stronger earnings in the GN Group in the years ahead.

The Board has appointed Niels B. Christiansen and Jesper Mailind to the Executive Management and we are confident that they will both be valuable contributors. Later today, you will be asked to consider an amendment to the Articles of Association that would permit an expansion of the Executive Management. The current articles prescribe a maximum of three members. Subject to your approval, the Executive Management will consist of Jørn Kildegaard (President & CEO), Jens Due Olsen (CFO), Niels B. Christiansen (headsets) and Jesper Mailind (hearing instruments and audiologic diagnostics equipment).

By expanding the Executive Management, we are enabling our executives to work more closely together, our organization becomes flatter and we will revitalize cooperation between our business areas, facilitating more cost reductions throughout the organization. This move confirms that GN is *not* a passive owner. Rather, we are actively involved in our four business areas. When we run our businesses more efficiently, we are also able to implement substantial cost savings.

The change will also bring the Supervisory Board closer to our businesses, making it more operational. Previously, our role was to be more involved in general strategic and structural issues.

In order to ensure a correlation between the interests of our shareholders and our senior employees, as well as to retain our key employees, GN has awarded options to selected employees for a number of years. We have made awards once a year to ensure that our share option plan always reflects current conditions on the stock market. Option awards of the past three years will not crystallize into a gain until our share price reaches DKK 50, or nearly three times the present level. Given the current share price, then, options awarded cannot be said to provide a true incentive or to help GN retain its key employees. Consequently, in spite of the current low share price, the Supervisory Board intends to award options also this year, albeit to a smaller group of employees. The awards will be subject to current authorizations and will be announced over the next couple of months.

As announced at last year's Annual General Meeting, when Per Harkjær was appointed to the Supervisory Board, we are gradually carrying out a generational change in this and the next few years. This will enable us to add the competencies GN Store Nord needs right now. Prior to today's meeting, Preben Schou has resigned from the Board, and, as previously announced, Cato Sverdrup does not wish to stand for re-election. Therefore, the Supervisory Board is proposing two new candidates for the Board: Jørgen Bardenfleth, who as managing director of Giga/Intel brings extensive experience from high-tech global companies, and Asger Domino, the managing director of Hartmann, who brings substantial experience from global manufacturing companies. Item g) on the Agenda contains a presentation of the new candidates proposed for the Board.

The Board of Directors also intends to table a resolution to cancel the 7.5% rule that restricts voting rights. In the Board's opinion, rules limiting voting rights belong in another time and age, and the best defense for any company will always be a good performance and a high share price.

Looking ahead, our expectations for 2003 are unchanged from the most recent announcement we made on January 2. We project that The New GN will generate revenues of approximately DKK 4.8 billion and an EBITA of about DKK 550 million in 2003, as compared with DKK 376 million in 2002. In other words, we expect to improve our operating profit by almost 50% compared with last year and by more than 80% over 2001.

I would note that we base this projection on a US dollar-Danish krone exchange rate of 7.25, whereas the current USD exchange rate is almost DKK 7. Fortunately, more than 50% of our revenue and about 60% of our costs are denominated in US dollars. Consequently, GN has limited earnings exposure only to movements in the USD-DKK exchange rate, but obviously, a weaker US dollar will pull down our revenue when expressed in Danish kroner.

We are often asked how sensitive GN's earnings are to the war in Iraq. In reality, it is impossible to answer that question, partly because it is impossible to predict how long the war will go on and how it will impact macroeconomic developments. However, we do know from similar situations that headset sales are much more cyclical than the sales of hearing instruments. As soon as we have meaningful information about whether the war will impact on GN's revenue and earnings, we will inform the market accordingly.

In that connection, I am pleased to tell you that GN has performed in line with expectations for the first couple of months of 2003. Let me also say that, unlike previously, we now have a much stronger business operation that is able to enhance earnings on its own, even with the global economic slump preventing any notable top-line growth.

Finally, I'd like to say this: I hope that that our performance and the commercial news we expect to announce in the period ahead will help eliminate the skepticism so many people have expressed towards GN Store Nord.

Following the large losses GN and our shareholders have suffered in connection with NetTest, the skepticism expressed in the stock market is understandable. But NetTest is no longer a part of GN. NetTest is history, and the GN of the future is showing visible improvements in headsets and hearing instruments on a strong strategic platform.

We expect that these improvements will translate into sharply improved earnings in 2003, and that GN will leave behind the effects of two very poor years and move on to an improved earnings performance. The members of the Supervisory Board, the Executive Management and GN's employees are all dedicated to making that happen. As I said earlier, I can promise you that nothing is sacred in our efforts to enhance GN's earnings.

Thank you!