

**Xaar plc** interim report 2006



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## Introduction

I am pleased to report that Xaar is continuing to make progress on most fronts and that the business remains robust. Sales of all existing products grew and fundamental demand for Xaar technology and solutions remains solid. As already announced, the one area which has caused concern is sales into China, details of which are set out below.

Xaar's prospects are underpinned by our new products, and interest in the platform 2 OmniDot 760 and our groundbreaking platform 3 Xaar 1001 (the commercial name for the HSS) has been strong. We expect to see the introduction of products incorporating these new printheads during 2007.

## Results and finance

Total group revenue for the six months to 30 June 2006 was £22.3 million (2005: £19.8 million), an increase of 13% over the same period last year. The comparative figure for last year included sales of £0.4 million (2006: £nil) by Vivid Print Innovations Inc., which was sold in March of this year. Revenue consisted of the sale of printheads and inks valued at £21.1 million (2005: £18.1 million), licensee royalties of £0.7 million (2005: £0.8 million) and development fees of £0.5 million (2005: £0.9 million).

Trading profit before tax was £4.8 million (2005: £4.9 million, before losses on the inter-company loan). Earnings per share were 5.5p (2005: 5.6p, before losses on the inter-company loan). The inter-company loan between the UK and Swedish operations was fully repaid during the period.

Production costs and capacity increased during the period and while this restricted profitability in the first half it represents an investment in the future as sales of existing products recover and volume sales of new products begin.

Cash generation was strong with cash at the half-year standing at £16.3 million, an increase of £1.9 million in the period (2005: £14.4 million at 31 December; £17.5 million at 30 June). This is after providing for capital investment in tangible assets of £2.6 million, intangible assets of £1.6 million and decreased working capital. The group's only debt is the outstanding balance on certain equipment leases totalling £1.0 million (2005: £1.5 million).

## China

The Chinese market is important to Xaar as China has now become the largest manufacturer of wide and grand format printers for the exterior graphics market, Xaar's core market today. In 2005, sales to China accounted for some 50% of printhead sales revenue, all from our platform 1 range of products. To date, Xaar has supplied products for this market on an ex-works basis and many customers choose to have their products delivered to Hong Kong.

After some evidence of slower payments by Chinese customers in the latter part of 2005, Xaar tightened its terms of trade early in 2006 which may have had some impact on sales. As already announced, on 19 July 2006 Xaar was notified by the Chinese customs authorities of an investigation into three of Xaar's customers with respect to alleged non-payment of import duties. This initial 90-day investigation is influencing other customers in China which have reduced orders to Xaar and Xaar's competitors whilst they conduct a review of their own importation policies and procedures. Xaar is not implicated in this investigation.

Xaar's management is moving quickly to put new arrangements in place for supplying the Chinese market. Xaar will now ship directly into mainland China, where goods will be held in a bonded warehouse for collection by customers. After-market sales of replacement heads for export markets served by our Chinese customers are, where appropriate, being made directly to end-users or local distributors.

## Business review

### Printheads and related products

Sales once again improved for all Xaar's printhead products. Despite the issues in China, sales to Asia were up 5% on the same period last year, sales to Europe and the Middle East increased by 23% and sales to the US were up by 17%. In Europe, our strategic partner in the development of the OmniDot 760, Agfa Gevaert, successfully completed the first installation of its new OmniDot based digital press, the M-Press, at SMP Group plc in London. Agfa expects this to pave the way for further installations as we move into next year.

Following the opening last year of our South American sales office in Sao Paulo, Brazil our first two customers in Brazil have launched locally manufactured wide format printers into the market. In India, sales have been slow to take off but we remain optimistic about the longer term prospects for this market.

### New markets

We continue to make progress in developing new markets for the future. I am particularly pleased to report that one of our Japanese strategic partners sold its first digital inkjet polyimide coating machine in the period. Polyimide coating is an essential part of the production of LCD screens. The machine was fitted with an OmniDot 760 print engine supplied by Xennia Technology Ltd and the interest in digital solutions for this market augers well for our future in this sector.

The LabelExpo tradeshow, currently being held in Chicago, includes important new product launches featuring Xaar printheads. PAT Technology Systems, a small company based in Canada, will preview a UV digital coating machine based on the new Xaar 1001 (HSS) printhead. Jetrion, a subsidiary of XSYS Print Solutions, will launch its new Jetrion 4000 digital label press based on the greyscale OmniDot 318 printhead. XSYS is one of the world's leading suppliers of commercial printing inks.

Elsewhere, the recent Mediatech tradeshow in Frankfurt saw the launch of two Xaar-based CD printers: one developed by Copytrax, a company based in Cambridge, UK and one by Werner Kammann Maschinenfabrik of Germany. Both machines use the OmniDot 318 printhead. In addition, development projects into packaging printing, 3D modelling and other sectors of the electronics industry continue to progress, although it is always difficult to predict the timing of commercialisation of such programmes.

### Technology revenues

Royalties from licensees were little changed from the first half of 2005 due to lower pricing by one licensee for a specific market application.

### New production facility

Progress on our new production facility in Huntingdon, UK remains on target for the start of commercial production in the first quarter of 2007. Equipment for the plant is now being delivered and is due to be commissioned during the final quarter of this year.

### Dividend

It is not the group's intention to pay an interim dividend but, subject to second half performance, it is our intention to declare a dividend for the full year.

### Outlook

The timing of the recovery in China remains uncertain and this will inevitably impact our second half results. We believe that the underlying demand for Xaar-based products in China remains strong and in the medium and longer term we remain positive about the group's prospects in Asian markets and elsewhere. Our medium and longer term growth will be driven by new products and new market applications which are now progressing towards volume production. These new products and markets will bring an increased spread of risk and an improving balance to revenues and profitability.



**Arie Rosenfeld**

Chairman

12 September 2006

**Board of directors****Arie Rosenfeld**

Chairman

**Ian Dinwoodie**

Chief Executive

**Nigel Berry**Finance Director and  
Deputy Chief Executive**Stephen Temple**

Technical Director

**Phil Eaves**

Sales and Marketing Director

**Richard King CBE**

Non-executive Deputy Chairman

**John Scott**

Senior Independent Director

**Robert Eckelmann**

Non-executive Director

**Registered office**Science Park  
Cambridge CB4 0XR**Registered number**

3320972

**Company secretary**

Andrew Taylor

**Financial advisor  
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Cambridge, England**Bankers**Barclays Bank plc  
15 Bene't Street  
Cambridge CB2 3PZ**Solicitors**Clifford Chance LLP  
10 Upper Bank Street  
London E14 5JJMills & Reeve  
Francis House  
112 Hills Road  
Cambridge CB2 1PH**Registrars**Capita Registrars  
The Registry  
34 Beckenham Road  
Beckenham BR3 4TU

	Notes	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
<b>Continuing operations</b>				
Revenue	1	22,296	19,849	42,772
Cost of sales		(9,274)	(7,944)	(16,123)
<b>Gross profit</b>		<b>13,022</b>	<b>11,905</b>	<b>26,649</b>
Distribution costs		(2,032)	(1,950)	(4,038)
Administrative expenses		(6,410)	(5,310)	(12,132)
<b>Operating profit</b>		<b>4,580</b>	<b>4,645</b>	<b>10,479</b>
Investment income		233	252	576
Finance costs		(39)	(34)	(63)
Foreign exchange loss on inter-company loan		—	(1,340)	(977)
<b>Profit before tax</b>		<b>4,774</b>	<b>3,523</b>	<b>10,015</b>
Tax		(1,432)	(1,057)	(2,966)
<b>Profit for the period attributable to shareholders</b>		<b>3,342</b>	<b>2,466</b>	<b>7,049</b>
<b>Earnings per share from continuing operations</b>				
Basic	2	5.5p	4.1p	11.6p
Diluted	2	5.2p	3.9p	11.1p

Dividends paid in the period amounted to £921,000 (six months to 30 June 2005: £604,000; twelve months to 31 December 2005: £604,000).

#### Consolidated statement of recognised income and expense for the six months ended 30 June 2006

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
Exchange differences on translation of foreign operations	(37)	678	842
Gains/(losses) on cash flow hedges	1,487	(2,485)	(2,545)
Tax on items taken directly to equity	(1,198)	—	1,690
<b>Net income/(loss) recognised directly in equity</b>	<b>252</b>	<b>(1,807)</b>	<b>(13)</b>
<b>Profit for the period</b>	<b>3,342</b>	<b>2,466</b>	<b>7,049</b>
<b>Total recognised income and expense for the period</b>	<b>3,594</b>	<b>659</b>	<b>7,036</b>

	As at 30 June 2006 (unaudited) £'000	As at 30 June 2005 (unaudited) £'000	As at 31 December 2005 (audited) £'000
<b>Non-current assets</b>			
Property, plant and equipment	8,633	5,546	6,436
Goodwill	720	771	720
Other intangible assets	4,770	3,228	3,773
Investments	1,768	234	1,377
Deferred tax asset	607	—	1,970
	<b>16,498</b>	<b>9,779</b>	<b>14,276</b>
<b>Current assets</b>			
Trade and other receivables	7,444	6,535	9,142
Inventories	3,358	2,086	2,835
Cash and cash equivalents	16,264	17,523	14,395
Derivative financial instruments	290	—	—
	<b>27,356</b>	<b>26,144</b>	<b>26,372</b>
Assets held for sale	—	—	265
<b>Total assets</b>	<b>43,854</b>	<b>35,923</b>	<b>40,913</b>
<b>Current liabilities</b>			
Trade and other payables	(8,986)	(8,199)	(7,875)
Current tax liabilities	(2,975)	(1,130)	(2,916)
Obligations under finance leases	(490)	(573)	(556)
Provisions	(188)	(134)	(120)
Derivative financial instruments	—	(1,137)	(1,197)
Liabilities directly associated with assets classified as held for sale	—	—	(15)
	<b>(12,639)</b>	<b>(11,173)</b>	<b>(12,679)</b>
<b>Net current assets</b>	<b>14,717</b>	<b>14,971</b>	<b>13,693</b>
<b>Non-current liabilities</b>			
Obligations under finance leases	(512)	(889)	(681)
<b>Total liabilities</b>	<b>(13,151)</b>	<b>(12,062)</b>	<b>(13,360)</b>
<b>Net assets</b>	<b>30,703</b>	<b>23,861</b>	<b>27,553</b>
<b>Equity</b>			
Share capital	6,147	6,057	6,115
Share premium	9,512	9,001	9,376
Own shares	(3,420)	(20)	(3,420)
Other reserves	2,695	2,104	2,386
Hedging and translation reserves	872	(595)	(131)
Retained earnings	14,897	7,314	13,227
<b>Equity attributable to shareholders</b>	<b>30,703</b>	<b>23,861</b>	<b>27,553</b>
<b>Total equity</b>	<b>30,703</b>	<b>23,861</b>	<b>27,553</b>

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
<b>Net cash from operating activities</b>	<b>6,791</b>	4,807	7,862
<b>Investing activities</b>			
Interest received	233	253	577
Purchases of property, plant and equipment	(2,626)	(1,252)	(2,579)
Proceeds on disposal of property, plant and equipment	5	—	1
Purchase of trading investments	(141)	(234)	(1,377)
Expenditure on product development	(1,412)	(469)	(1,220)
<b>Net cash used in investing activities</b>	<b>(3,941)</b>	(1,702)	(4,598)
<b>Financing activities</b>			
Dividends paid	(921)	(604)	(604)
Proceeds from issue of ordinary share capital	162	333	754
Repayments of obligations under finance leases	(261)	(285)	(553)
Purchase of own shares	—	—	(3,400)
<b>Net cash used in financing activities</b>	<b>(1,020)</b>	(556)	(3,803)
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,830</b>	2,549	(539)
<b>Cash and cash equivalents at beginning of period</b>	<b>14,395</b>	15,316	15,316
Effect of foreign exchange rates	39	(342)	(382)
<b>Cash and cash equivalents at end of period</b>	<b>16,264</b>	17,523	14,395

## 1. Segmental analysis

### Business segments

For management reporting purposes, the group's operations are currently analysed according to product type. These product groups are the basis on which the group presents its primary segment information.

Segment information about these product types is presented below:

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
<b>Revenue</b>			
Printheads and related products	21,112	18,094	39,872
Development fees	497	948	1,587
Licence fees and royalties	687	807	1,313
<b>Total</b>	<b>22,296</b>	<b>19,849</b>	<b>42,772</b>

### Geographical segments

The group's operations are located in Europe, Asia and North and South America. The following table provides an analysis of the group's sales by geographical market, irrespective of the origin of the goods:

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
Europe and Middle East	8,035	6,519	14,025
Americas	2,306	1,968	3,307
Asia	11,955	11,362	25,440
<b>Total</b>	<b>22,296</b>	<b>19,849</b>	<b>42,772</b>

## 2. Earnings per ordinary share – basic and diluted

The calculation of earnings per share is based upon the following data:

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
<b>Earnings</b>			
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	3,342	2,466	7,049
<b>Number of shares</b>			
Weighted average number of ordinary shares for the purposes of basic earnings per share	61,323,233	60,367,096	60,578,422
Effect of dilutive potential ordinary shares:			
Share options	2,405,029	2,828,964	2,921,181
Weighted average number of ordinary shares for the purposes of diluted earnings per share	63,728,262	63,196,060	63,499,603

## 2. Earnings per ordinary share – basic and diluted (continued)

The calculation of earnings per share excluding foreign exchange loss on the inter-company loan is based on earnings of:

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	3,342	2,466	7,049
Foreign exchange loss on the inter-company loan	—	1,340	977
Tax effect of loss on inter-company loan	—	(402)	(293)
Profit on ordinary activities after tax excluding foreign exchange loss on the inter-company loan	3,342	3,404	7,733

The denominators used are the same as those detailed above for both basic and diluted earnings per share.

Earnings per share excluding foreign exchange loss on the inter-company loan:

	Six months to 30 June 2006 (unaudited) £'000	Six months to 30 June 2005 (unaudited) £'000	Twelve months to 31 December 2005 (audited) £'000
Basic	5.5p	5.6p	12.8p
Diluted	5.2p	5.4p	12.2p

This additional earnings per share information is considered to provide a fairer representation of the group's trading performance year on year.

## 3. Financial information

These interim financial statements do not constitute statutory financial statements within the meaning of section 240 of the Companies Act 1985. The results for the year ended 31 December 2005 have been extracted from the statutory financial statements, which have been filed with the Registrar of Companies. Without qualifying their opinion on the financial statements for the year ended 31 December 2005, the previous auditors drew attention, by way of emphasis, to disclosures concerning the possible outcome of amounts due from some of the group's debtors. They concluded that there was uncertainty over both the timing and quantum of amounts which may be recovered.

The unaudited interim financial statements for the six months ended 30 June 2006 have been prepared on the basis of the accounting policies set out in the most recently published financial statements of the Group for the year ended 31 December 2005.

## 4. Date of approval of interim financial statements

The interim financial statements cover the period 1 January 2006 to 30 June 2006 and were approved by the board on 12 September 2006.

The interim financial statements will be sent to shareholders in due course. Further copies will be available from the Company's registered office, Science Park, Cambridge CB4 0XR and can be accessed on the Xaar plc website, [www.xaar.co.uk](http://www.xaar.co.uk).

### Introduction

We have been instructed by the company to review the financial information for the six months ended 30 June 2006 which comprises the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement and the related notes 1 to 4. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with guidance contained in Bulletin 1999/4 "Review of interim financial information" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our work, for this report, or for the conclusions we have formed.

### Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

### Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 "Review of interim financial information" issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with International Standards on Auditing (UK and Ireland) and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

### Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2006.

### Ernst & Young LLP

Cambridge

12 September 2006

### Notes:

The maintenance and integrity of the Xaar plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial information since it was initially first presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



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