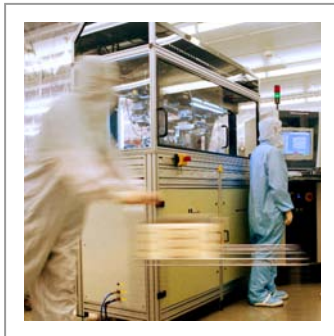
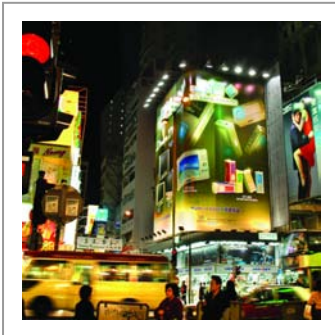




Interim Report 2005



Introduction

I am pleased to report another six months of strong growth and profitability for the group, together with the important commercial launch of our new OmniDot range of printheads and the announcement of plans to add a new production facility in the UK.

Results and Finance

For the first time the results have been prepared under International Financial Reporting Standards (IFRS) as required by EU legislation for most listed European companies with reporting periods starting on or after 1 January 2005.

Under IFRS, total group revenue was £19.8 million (2004: £16.6 million) for the period, an increase of 19% over the same period last year. Included in revenue is the sale of printheads and inks valued at £18.4 million (2004: £15.7 million), licensee royalties of £0.8 million (2004: £0.6 million) and development fees of £0.6 million (2004: £0.3 million).

The profit from operations (as defined by IFRS, i.e. profit before net interest, exchange rate movement on the inter-company loan, tax and dividends) for the period was £4.6 million (2004: £2.5 million). The exchange rate movement on the inter-company loan between the UK and Sweden resulted in a book loss of £1.3 million (2004: £1.3 million loss). After accounting for this movement, profit before tax was £3.5 million (2004: £1.3 million) and the tax charge for the period was £1.1 million (2004: £0.4 million). Earnings per share, excluding translation movements on the inter-company loan, were 5.6p (2004: 3.0p) and including currency translation movements on the inter-company loan were 4.1p (2004: 1.5p).

The results were previously reported under UK Generally Accepted Accounting Principles (UK GAAP), which was also the basis of the trading update issued in July of this year. A financial reconciliation and further explanation of the differences between the IFRS and UK GAAP results can be found in note 4 to the interim statement. The net effect of the change to IFRS reporting on profit before tax for the period was to increase it by £0.3 million. For the 2004 comparative there was an increase of £0.1 million.

Cash generation in the period was again strong with cash at the half-year standing at £17.5 million (2004: £9.9 million). This is after providing for capital investment in tangible assets of £1.3 million, trade investments of £0.2 million and an increase in working capital of £0.6 million. Outstanding liabilities under finance leases were £1.5 million (2004: £1.4 million).

Business Review

Printheads and related products

Sales improved for all Xaar's printhead products in all market sectors. Our industry-standard XJ128 and XJ128 Plus printheads continue to dominate the wide format graphic arts market where they are primarily used to print outdoor advertising media and other outdoor signage. The XJ500 continues to find success in both the wide format graphics market and the secondary packaging market, where coding directly onto external packaging is eliminating the need for pre-printed barcode labels. Sales of the OmniDot 318 (formerly Leopard) printhead also continued to grow.

Sales to Asia were up 20% on the same period last year, with sales to Europe up by 16% and sales to the US up by 25%. Our new office in

India, opened in late 2004, is starting to develop direct sales to this market and we have recently taken on our first full time sales person in South America, based in Sao Paulo, Brazil.

The major new product news from the first half was the successful commercial launch of the greyscale OmniDot 760, which made its debut in a commercial printing product in May at the FESPA tradeshow in Munich, Germany. The OmniDot was co-developed with Agfa, who demonstrated it at the show in both a grand format graphics printer, the Anapurna 100, and a revolutionary new digital press, the M-Press, which is the most advanced product of its type yet built. The M-Press in particular generated tremendous interest from potential end users and Agfa is due to begin deliveries later this year.

Xaar's own version of the OmniDot 760 printhead has been supplied in evaluation-kit form to both existing and new customers and we would expect equipment based on the new printhead to be in the market towards the end of 2006. The smaller and variable drop size offered by the OmniDot allows much higher resolution printing which, in turn, opens up the indoor advertising and fine art market to Xaar. This will add an incremental layer of sales to those generated by our existing product portfolio. The OmniDot range will also include a binary version (the OM 380) which will fill the space between the XJ128 and XJ500 printheads in both the wide format and coding markets.

Looking further ahead, we have also shipped early test kits of our next new printhead platform, currently referred to as the HSS. This printhead has a patented recirculating ink system giving it the ability to self-recover from blocked nozzles.

This makes it inherently much more reliable than conventional inkjet printheads. The recirculating principle also allows a much wider range of fluids to be used in the printhead; we believe these features will not only open up new areas of traditional printing to inkjet, but will also take inkjet into new industrial processes where patterns and images are today produced by wasteful subtractive processes rather than by direct printing.

New Markets

Our business development activities generated initial revenues during the period and continue to gather pace. We are actively involved in a range of projects covering printed electronics, packaging, electronic displays and biotech. These projects include: the printing of etch masks for the manufacture of printed circuit boards, where we expect to see commercial equipment released later in the year; the printing of aerosol and beverage cans; the repair of LCD screens and other deposition related processes within the manufacture of electronic displays, and the use of inkjet in textile printing for which we have OmniDot evaluation kits on trial in the field.

In each of these areas we work very closely with our approved integration partners whose skill in applying our technology to each customer's particular application is very important.

Xennia Technology Ltd.

We recently made a minority investment in Xennia Technology Ltd., one of our approved integration partners. As a result we now own 10% of the company with an option to increase this to 12.5%. The investment is intended to strengthen further our relationship with Xennia

and it is not currently our intention to increase our stake beyond that of a minority shareholder.

Where appropriate, it is our intention to make other small trade investments if these can speed adoption of our technology into existing and new markets.

Technology Revenues

Royalties from licensees increased during the period compared to both the first and second half of 2004. This growth comes primarily from Toshiba TEC, Konica Minolta, Toyo Ink, Seiko Instruments, and Brother. Our licensees use Xaar technology across a range of markets including graphic arts, document printing and mailing.

New Production Facility

With the launch of the OmniDot range, manufactured in our production facility in Sweden for both ourselves and Agfa, it is likely that the Swedish plant will become fully utilised in the short to medium term. In order to provide capacity for the introduction of the HSS product range, as well as to provide further capacity for existing products, we have decided to add a second production facility in the vicinity of our Cambridge headquarters. We have identified several possible leasehold buildings and expect to finalise negotiations on one of these sites by the end of the year. Initial equipment and fit-out costs for the new facility are expected to be around £7.0 million and the total commitment including working capital is likely to be in the order of £10.0 million. Commercial volume production of the first model in the HSS printhead range is scheduled to begin by the end of 2006. The investment in the new facility will be met from the group's existing cash reserves.

Board

We are delighted to have appointed Mr Robert Eckelmann as a non-executive director with effect from 1 October 2005. Mr Eckelmann, 49, has a strong background in the electronics industry; having launched Intel's Asian business, he later became VP and General Manager for the whole of Intel's EMEA region.

Dividend

As previously stated, due to the administrative time and cost involved in making a dividend payment it is not the group's intention to pay an interim dividend but, subject to a satisfactory second half performance, it is our intention to declare a dividend for the full year.

Outlook

All of our core markets met or exceeded expectations during the period and the board expects to achieve a satisfactory result for the year as a whole.



Arie Rosenfeld, Chairman
14 September 2005

Consolidated income statement for the six months ended 30 June 2005

	Notes	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Continuing operations				
Revenue	1	19,849	16,589	34,812
Cost of Sales		(7,944)	(7,305)	(15,078)
Gross profit		11,905	9,284	19,734
Other operating expenses (net)		(7,260)	(6,793)	(13,440)
Profit from operations		4,645	2,491	6,294
Investment Income		252	97	306
Finance Costs		(34)	(67)	(100)
Foreign exchange loss on intercompany loan		(1,340)	(1,250)	(231)
Profit before taxation		3,523	1,271	6,269
Tax		(1,057)	(359)	(1,658)
Profit for the period from continuing operations		2,466	912	4,611
Dividend		(604)	-	-
Profit for the period		1,862	912	4,611
Earnings per share - basic	2	4.1p	1.5p	7.7p
Earnings per share - diluted	2	3.9p	1.5p	7.5p

Consolidated statement of recognised income and expense for the six months ended 30 June 2005

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Exchange differences on translation of foreign operations	678	746	(136)
Net income recognised directly in equity	678	746	(136)
Profit for the period	1,862	912	4,611
Total recognised income and expense for the period attributable to shareholders	2,540	1,658	4,475

Consolidated balance sheet as at 30 June 2005

	As at 30 June 2005 (unaudited) £'000	As at 30 June 2004 (unaudited) £'000	As at 31 December 2004 (unaudited) £'000
Non-current assets			
Goodwill	771	771	771
Other intangible assets	3,228	2,147	2,958
Tangible assets	5,546	5,241	5,623
Investments	234	-	-
	9,779	8,159	9,352
Current assets			
Inventories	2,086	2,226	2,485
Trade and other receivables	6,535	6,323	6,771
Short term investments	-	2,945	900
Cash and cash equivalents	17,523	6,946	14,416
	26,144	18,440	24,572
Total assets	35,923	26,599	33,924
Current liabilities			
Amounts falling due in one year	(11,039)	(5,812)	(9,258)
Short-term provisions	(134)	(496)	(134)
	(11,173)	(6,308)	(9,392)
Net current assets	14,971	12,132	15,180
Non-current liabilities			
Obligations under finance leases	(889)	(1,446)	(1,278)
Total liabilities	(12,062)	(7,754)	(10,670)
Net assets	23,861	18,845	23,254
Equity			
Share capital	6,057	6,004	6,013
Share premium	9,001	8,648	8,713
Own shares	(20)	(20)	(20)
Other reserves	2,104	1,229	1,884
Hedging and translation reserves	(595)	746	1,212
Retained earnings	7,314	2,238	5,452
Equity attributable to shareholders	23,861	18,845	23,254
Total equity	23,861	18,845	23,254

Cash flow statement for the six months ended 30 June 2005

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Net cash from operating activities	4,807	3,338	10,224
Investing activities			
Interest received	253	79	308
Purchases of property, plant and equipment	(1,252)	(635)	(1,748)
Proceeds on disposal of property, plant and equipment	-	-	9
Acquisition of an investment in an associate	(234)	-	-
Expenditure on product development	(469)	(830)	(1,583)
Net cash used in investing activities	(1,702)	(1,386)	(3,014)
Financing activities			
Dividends paid	(604)	-	-
Proceeds from issue of ordinary share capital	333	105	179
Repayments of obligations under finance leases	(285)	(318)	(623)
Net cash used in financing activities	(556)	(213)	(444)
Net increase in cash and cash equivalents	2,549	1,739	6,766
Cash and cash equivalents at beginning of period	15,316	8,458	8,458
Effect of foreign exchange rates	(342)	(306)	92
Cash and cash equivalents at end of period	17,523	9,891	15,316

Notes to the interim financial information

1. Segmental analysis

The segmental analysis of turnover is:

		6 months to 30 June 2005 £'Million	6 months to 30 June 2004 £'Million	12 months to 31 December 2004 £'Million
Geographic:	Europe & Middle East	6.5	5.6	11.3
	Americas	2.0	1.6	3.8
	Asia	11.3	9.4	19.7
	Total	19.8	16.6	34.8
Industry segment:	Graphic arts	14.5	12.3	25.6
	Packaging printing	3.1	2.9	6.6
	Industrial printing	0.8	0.5	0.9
	Development fees	0.6	0.3	0.6
	Licence fees and royalties	0.8	0.6	1.1
	Total	19.8	16.6	34.8

2. Earnings per ordinary share - basic and diluted

The calculation of earnings per share is based upon the profit for the period after taxation and on the weighted average number of ordinary shares in issue during the period. For basic

earnings per share, this is 60,367,096 (30 June 2004: 60,003,648, 31 December 2004: 60,043,056) and for diluted earnings per share, this is 63,196,060 (30 June 2004: 61,260,066, 31 December 2004: 61,746,960), the only difference being in relation to movements in share options.

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Earnings per share excluding foreign exchange loss on intercompany loan - basic	5.6p	3.0p	7.9p
Earnings per share excluding foreign exchange loss on intercompany loan - diluted	5.4p	2.9p	7.7p

Basic earnings per share excluding foreign exchange loss on the intercompany loan is based on earnings of:

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Profit for the period from continuing operations	2,466	912	4,611
Foreign exchange loss on the intercompany loan	1,340	1,250	231
Tax effect of loss on intercompany loan	(402)	(375)	(69)
Retained earnings for the financial period excluding foreign exchange loss on the intercompany loan	3,404	1,787	4,773

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 2004 have been extracted from the statutory financial statements, which have been filed with the Registrar of Companies and upon which the auditors reported without qualification.

4. Reconciliation between IFRS and UK GAAP

The key changes made to the group's UK GAAP results to comply with IFRS are:

- Capitalisation of certain product development costs and deferral of associated third party contributions towards those development costs.

Under UK GAAP, capitalisation of product development expenditure was optional and the group did not capitalise these costs. To comply with IFRS, costs associated with development of the OmniDot product range in 2003 and 2004, and the HSS product range in 2004 and 2005 have now been capitalised. These costs will be amortised over a three year period on the basis of unit

shipments beginning in the year in which the products are first commercially sold. This will be 2005 for the OmniDot range and potentially late 2006 or early 2007 for the HSS range.

In tandem with capitalising development costs for the OmniDot products, we are also obliged to defer recognition of the contributions received towards those costs from Agfa, our co-development partner. Such deferred revenues will be released in parallel with amortisation of the capitalised development costs for this product.

- Expensing of share options.

The group has expensed the cost of share options issued to executives and employees in accordance with the methodology set out by IFRS2.

- Amortisation of goodwill arising on acquisition of the group's Swedish operations in 1999 and Vivid Print Innovations in 2003.

Under UK GAAP, such goodwill was being amortised through the profit and loss account over a ten year period. Under IAS38, the fair value of such balance sheet assets must be assessed on an annual basis by the group's directors, with any permanent change in fair value taken through the profit and loss account. The directors do not consider there has been any change in the fair value of these items during 2004, or in the first half of 2005. As a result, amortisation previously charged in the 2004 results has been written back to profit, and no charge has been made in the first half of the current year.

Reconciliations between IFRS results and UK GAAP results for the major financial headings are shown below.

Profit before tax

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Profit before tax under IFRS	3,523	1,271	6,269
Capitalisation of R&D (net) ¹	(461)	(78)	(456)
Cost of share options ²	220	74	244
Amortisation of goodwill ³	(71)	(72)	(143)
	(312)	(76)	(355)
Profit before tax under UK GAAP	3,211	1,195	5,914
Foreign exchange loss on inter company loan	1,340	1,250	231
Trading profit under UK GAAP	4,551	2,445	6,145

1. Where the company's R&D programmes meet the criteria set out in IAS38, the costs have been capitalised as an intangible asset and amortised as appropriate.
2. Share options granted after 7 November 2002 that have not vested are measured, in accordance with IFRS2, at their fair value as determined by the Black Scholes option pricing model. The fair value of these options is written off over the vesting period of the individual option.
3. Under IAS38 goodwill is held at its 31 December 2003 value unless there is impairment to its value.

Net assets

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Net assets (IFRS)	23,861	18,845	23,254
Non-current asset adjustments ¹	(2,738)	(1,426)	(2,250)
Current asset adjustments ²	318	-	(1,030)
Current liabilities adjustments ^{2,3}	2,719	1,262	1,025
Net assets (UK GAAP)	24,160	18,681	20,999

- Where the company's R&D programmes meet the criteria set out in IAS38, the costs have been capitalised as an intangible asset. The cost of R&D programmes capitalised at 30 June 2005 is £2,524k (30 June 2004: £1,354k, 31 December 2004: £2,107k).
- Under IAS39 where hedge accounting is adopted, any movement in the valuation of financial instruments is shown on the face of the balance sheet with the effect of this movement being recognised in the hedging and translation reserve. The effect of these movements at 30 June 2005 is a liability of £1,137k (30 June 2004: nil, 31 December 2004: asset of £1,348k).
- Income received in relation to the company's R&D programmes that directly relates to the intangible assets booked under IAS38 is held as deferred income and amortised in accordance with the amortisation profile for the associated intangible asset. Deferred income at 30 June 2005 is £1,593k (30 June 2004: £1,262k, 31 December 2004: £1,637k).

Shareholders' equity

	6 months to 30 June 2005 (unaudited) £'000	6 months to 30 June 2004 (unaudited) £'000	12 months to 31 December 2004 (unaudited) £'000
Total equity (IFRS)	23,861	18,845	23,254
Retained earnings adjustments	(838)	(164)	(907)
Valuation of financial instruments (hedging and translation reserve) ¹	1,137	-	(1,348)
Total equity (UK GAAP)	24,160	18,681	20,999

- Under IAS39 where hedge accounting is adopted, any movement in the valuation of financial instruments is taken to the hedging and translation reserve.

Introduction

We have been instructed by the company to review the financial information for the six months ended 30 June 2005 which comprises the profit and loss account, the balance sheets, the cash flow statement and related notes 1 to 4. We have read the other information contained in the interim report and considered whether it contains any apparent mis-statements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review 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 are consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

International Financial Reporting Standards

As disclosed in note 4, the next annual financial statements of the group will be prepared in accordance with International Financial Reporting Standards as adopted for use in the EU. Accordingly, the interim report has been prepared in accordance with the recognition and measurement criteria of IFRS and the disclosure requirements of the Listing Rules.

Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 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 2005.

Deloitte & Touche LLP
Chartered Accountants
Cambridge
England
13 September 2005

Notes: A review does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.



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