



Chairman's statement	01
Directors and advisors	03
Consolidated income statement	04
Consolidated statement of recognised income and expense	04
Consolidated balance sheet	05
Consolidated cash flow statement	06
Notes to the interim financial information	07
Independent review report	09

Chairman's statement

Introduction

In what is my first statement as Chairman of Xaar plc, I am pleased to report on the continued progress for the group. Sales of established products have recovered well from the second half of last year and the potential for our newer technologies is undiminished. Last year we invested significantly in the new production facility in Huntingdon; production began as planned in January, and this facility is now fully operational.

The results for the first half reflect the additional costs of this investment in our future. It is our strong belief that we have developed the right products to benefit from what will become a rapid escalation in the rate of adoption of inkjet technology by more traditional areas of the commercial print market, although exact timing remains difficult to predict.

Results

Group revenues for the six months ending 30 June 2007 were in line with the board's expectations at £23.4m (2006: £22.3m), an increase of 5% over the same period last year and 18% ahead of the half year to 31 December 2006. The majority of the revenue was product sales of £22.4m (2006: £21.1m), with royalty income of £0.8m (2006: £0.7m) and development fees of £0.2m (2006: £0.5m).

Royalty growth continued, albeit at a modest rate, confirming the relevance of Xaar's technology in the market. As expected, development fees more than halved as Agfa, with which we have a technology agreement, has moved into the commercialisation stage of its inkjet programme, with a consequent reduction in its ongoing research and associated development payments to Xaar.

Profitability was also in line with expectations. The overall group gross margin for the period was 53%, reflecting the dilutive effects of the early stages of new product manufacturing in Sweden and the initiation of production at the new Huntingdon facility. As the production of new products ramps up, gross margins are expected to remain broadly at this level during the second half year.

Overall, operating expenses increased by £0.9m, including increased amortisation of capitalised research and development costs and increased staff incentive payments.

Profit before tax was £3.1m (2006: £4.8m) after providing £0.4m (2006: £0.3m) for share-based payments; earnings per share were 3.6p (2006: 5.5p).

Cash at the half year was £10.0m (2006: £16.3m) reflecting the final stage payments on equipment in the new Huntingdon facility as well as the increased final dividend payment for 2006 of £1.2m. The group's only debt at the half year was the outstanding balance on certain equipment leases of £1.4m (2006: £1.0m).

Business commentary

Shareholders will recall the difficulties in China during the second half of last year; I am pleased to confirm that sales have more than fully recovered. Revenue growth for Asia overall was 17%, driven by strong growth in both China and India.

Sales to the Americas, whilst representing only 11% of the total group sales, grew by 45% in the period amid encouraging signs from our South American sales operation.

The pleasing growth shown in Asia and the Americas was not matched in Europe, which showed a 20% decline over the period, although revenues were up 4% compared to the second half of last year. We do not believe the first half shortfall reflects any fundamental trend, but is rather due to the individual performances of certain customers in the period.

Shareholders will be aware that our geographical split reflects the location of the printing machine manufacturer, and not the end users of those machines; consequently fluctuations in sales to particular territories do not always relate directly to the end user market in those areas.

Chairman's statement continued

“...It is our strong belief that we have developed the right products to benefit from what will become a rapid escalation in the rate of adoption of inkjet technology...”

Markets and technology

Inkjet is firmly established as the 'technology of choice' for the large and grand-format commercial print sector. This provides a solid market for our Platform 1 products, which continue to grow even though our best-selling XJ128 printhead was first introduced in its original form over ten years ago. Xaar's newer Platform 2 and Platform 3 products represent incremental markets. There are an increasing number of these products under test with global printing equipment manufacturers and ink companies, and we expect some of these developments to move to commercial production later this year, with others making that transition in 2008. As we have previously highlighted, the timing of such printing machinery product launches is not in the company's control and therefore is difficult to predict. However, once the newer products are in production we can look forward to sustained long term revenue from them, as with our earlier Platform 1 products.

In June 2007, during the international FESPA exhibition in Berlin, we gave the first public demonstration of four colour, single pass, continuous web-based printing using our latest Xaar 1001 product. This demonstration created a significant amount of positive interest and, together with a number of other sales and marketing initiatives, is creating a healthy spread of evaluation kits installed across commercial printing markets. This adds further to the pipeline of potential future sales.

The markets for non-print related uses of inkjet continue to look positive in the longer term, but more immediate opportunities for our technology, and the Xaar 1001 product in particular, exist in packaging markets. Accordingly, we intend now to focus much of our business development activities on the packaging and label markets.

Board changes

Steve Temple, 60, one of the founders of Xaar and mainstay for innovation and patent registrations for so many years, has decided to step down from the board and from his role as Technical Director. We thank Steve for his immense contribution to Xaar, and to the establishment of the very successful Cambridge 'inkjet cluster'. Following a handover period, Steve will remain a consultant to the company.

We are pleased to have appointed Ramon Borrell as Research and Development Director with effect from September of this year. Over the last 13 years, Ramon has held various senior positions within the research and development team at Hewlett-Packard's large format printing division, based in Spain, and as a result joins us with a good understanding of inkjet and its markets.

Dividend

In line with recent years, it is not our intention to pay an interim dividend but, subject to second half performance, it is our intention to pay a dividend for the full year.

Outlook

Currently less than 10% of commercial printing worldwide is understood to be produced using inkjet technology, with the bulk of commercial print produced using traditional printing methods. From my own experience, it is clear inkjet markets offer significant long term growth prospects. At Xaar, we have world leading technology and a growing reputation for performance. Our challenge is to help accelerate the development of new printing machines that utilise our technology, and which encompass our highly functional printheads. As inkjet technologies mature, and gain wider acceptance, we believe Xaar is well positioned to capitalise on the opportunities this is now bringing.



Phil Lawler
Chairman
11 September 2007

Directors and advisors

Phil Lawler
Chairman

Ian Dinwoodie
Chief Executive

Nigel Berry
Finance Director and
Deputy Chief Executive

Stephen Temple
Technical Director

Phil Eaves
Sales and Marketing Director

Ramon Borrell
Research and Development Director

Richard King CBE
Non-executive Deputy Chairman

John Scott
Senior Independent Director

Robert Eckelmann
Non-executive Director

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Consolidated income statement

for the six months ended 30 June 2007

	Notes	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Revenue	1	23,441	22,296	42,207
Cost of sales		(11,092)	(9,274)	(18,096)
Gross profit		12,349	13,022	24,111
Distribution costs		(1,962)	(2,032)	(4,108)
Administrative expenses		(7,396)	(6,410)	(13,426)
Operating profit		2,991	4,580	6,577
Investment income		193	233	451
Finance costs		(62)	(39)	(116)
Profit before tax before abortive deal costs and share-based payments		3,553	5,082	7,921
Abortive deal costs		—	—	(298)
Share-based payments		(431)	(308)	(711)
Profit before tax		3,122	4,774	6,912
Tax		(874)	(1,432)	(2,068)
Profit for the period attributable to shareholders		2,248	3,342	4,844
Earnings per share				
Basic	2	3.6p	5.5p	7.9p
Diluted	2	3.5p	5.2p	7.6p

Dividends paid in the period amounted to £1,218,000 (six months to 30 June 2006: £921,000; twelve months to 31 December 2006: £903,000).

Consolidated statement of recognised income and expense

for the six months ended 30 June 2007

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Exchange differences on translation of foreign operations	55	(37)	(113)
(Losses)/gains on cash flow hedges taken in equity	(18)	1,487	1,197
Tax on items taken directly to equity	222	(1,198)	(415)
Net income recognised directly in equity	259	252	669
Profit for the period	2,248	3,342	4,844
Total recognised income and expense for the period	2,507	3,594	5,513

Consolidated balance sheet

as at 30 June 2007

	As at 30 June 2007 (unaudited) £'000	As at 30 June 2006 (unaudited) £'000	As at 31 December 2006 (audited) £'000
Non-current assets			
Property, plant and equipment	11,886	8,633	11,990
Goodwill	720	720	720
Other intangible assets	7,097	4,770	7,030
Investments	2,020	1,768	1,931
Deferred tax asset	916	607	1,383
	22,639	16,498	23,054
Current assets			
Inventories	4,098	3,358	3,690
Trade and other receivables	7,041	7,444	6,135
Current tax assets	834	188	757
Cash and cash equivalents	10,033	16,264	12,438
Derivative financial instruments	36	290	—
	22,042	27,544	23,020
Total assets	44,681	44,042	46,074
Current liabilities			
Trade and other payables	(7,181)	(8,986)	(7,928)
Other financial liabilities	(191)	—	(185)
Current tax liabilities	(308)	(3,163)	(1,264)
Obligations under finance leases	(453)	(490)	(468)
Provisions	(164)	(188)	(209)
Derivative financial instruments	(18)	—	—
	(8,315)	(12,827)	(10,054)
Net current assets	13,727	14,717	12,966
Non-current liabilities			
Deferred tax liabilities	(1,635)	—	(1,635)
Other financial liabilities	(752)	—	(865)
Obligations under finance leases	(42)	(512)	(267)
	(2,429)	(512)	(2,767)
Total liabilities	(10,744)	(13,339)	(12,821)
Net assets	33,937	30,703	33,253
Equity			
Share capital	6,275	6,147	6,201
Share premium	10,048	9,512	9,669
Own shares	(4,465)	(3,420)	(3,420)
Other reserves	3,528	2,695	3,097
Hedging and translation reserves	635	872	593
Retained earnings	17,916	14,897	17,113
Equity attributable to shareholders	33,937	30,703	33,253
Total equity	33,937	30,703	33,253

Consolidated cash flow statement

for the six months ended 30 June 2007

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Net cash from operating activities	2,905	6,791	8,692
Investing activities			
Interest received	193	233	450
Purchases of property, plant and equipment	(2,177)	(2,626)	(7,274)
Proceeds on disposal of property, plant and equipment	—	5	5
Purchases of trading investments	(89)	(141)	(427)
Payments to acquire intangible assets	(1,084)	(1,412)	(3,420)
Net cash used in investing activities	(3,157)	(3,941)	(10,666)
Financing activities			
Dividends paid	(1,218)	(921)	(903)
Proceeds from issue of ordinary share capital	449	162	384
New borrowings	—	—	1,050
Repayments of borrowings	(107)	—	—
Repayments of obligations under finance leases	(224)	(261)	(520)
Purchase of own shares	(1,045)	—	—
Net cash (outflow)/inflow from financing activities	(2,145)	(1,020)	11
Net (decrease)/increase in cash and cash equivalents	(2,397)	1,830	(1,963)
Effect of foreign exchange rate changes	(8)	39	6
Cash and cash equivalents at beginning of period	12,438	14,395	14,395
Cash and cash equivalents at end of period	10,033	16,264	12,438

Notes to the interim financial information

for the six months ended 30 June 2007

1. Business and geographical segments

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 reports its primary segment information.

Segment information about these product types is presented below:

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Revenue			
Printheads and related products	22,353	21,112	39,918
Development fees	244	497	748
Licence fees and royalties	844	687	1,541
Total revenue	23,441	22,296	42,207

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 revenue by geographical market, which is considered to be the group's secondary segment:

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Asia	13,940	11,955	23,937
Europe and Middle East	6,800	8,479	14,997
Americas	2,701	1,862	3,273
Total revenue	23,441	22,296	42,207

2. Earnings per ordinary share – basic and diluted

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

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Earnings			
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	2,248	3,342	4,844
Number of shares			
Weighted average number of ordinary shares for the purposes of basic earnings per share	62,246,666	61,323,233	61,447,492
Effect of dilutive potential ordinary shares:			
Share options	1,729,183	2,405,029	2,221,595
Weighted average number of ordinary shares for the purposes of diluted earnings per share	63,975,849	63,728,262	63,669,087

Notes to the interim financial information continued

for the six months ended 30 June 2007

2. Earnings per ordinary share – basic and diluted continued

Adjusted earnings per share

The calculation of earnings per share excluding abortive deal costs and share-based payments is based on earnings of:

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	2,248	3,342	4,844
Abortive deal costs	—	—	298
Share-based payments	431	308	711
Tax effect of adjusting items	(129)	(92)	(303)
Profit after tax excluding abortive deal costs and share-based payments	2,550	3,558	5,550

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

Earnings per share excluding abortive deal costs and share-based payments:

	Six months ended 30 June 2007 (unaudited) £'000	Six months ended 30 June 2006 (unaudited) £'000	Twelve months ended 31 December 2006 (audited) £'000
Basic	4.1p	5.8p	9.0p
Diluted	4.0p	5.6p	8.7p

This adjusted 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 2006 have been extracted from the statutory financial statements, which have been filed with the Registrar of Companies. The auditor's report on those accounts was unqualified and did not contain a statement made under section 237 (2) or section 237 (3) of the Companies Act 1985.

The unaudited interim financial statements for the six months ended 30 June 2007 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 2006.

4. Date of approval of interim financial statements

The interim financial statements cover the period 1 January 2007 to 30 June 2007 and were approved by the board on 11 September 2007.

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.com.

Independent review report

to Xaar plc

Introduction

We have been instructed by the company to review the financial information for the six months ended 30 June 2007 which comprises the consolidated income statement, consolidated statement of recognised income and expense, consolidated balance sheet, 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 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 2007.

Ernst & Young LLP
Cambridge
11 September 2007



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