

FORWARD THINKING

XAAR PLC
Half-yearly report
2008

WHO?

The beginning: Xaar was established in 1990 to acquire, develop and commercially exploit a new digital inkjet printing technology arising out of work done by Cambridge Consultants Ltd. At the time, the IPR consisted of four granted patents and 84 patent applications in various jurisdictions.

Today: as a result of further development of the core technology there are now over 700 patents and patent applications in the Xaar IPR portfolio and the 300 employee-strong company continues to improve and expand this portfolio. Today the company's core business is to manufacture and sell its wide range of printheads and peripheral equipment to leading OEM companies, in addition to licensing the Xaar technology to global brand companies.

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CHAIRMAN'S STATEMENT

Phil Lawler, Chairman

- Results for the period reflect improved profitability despite lower than expected sales into China
- Maiden interim dividend of 1.0p per share will be paid
- Continued strong interest in new Platform 2 and Platform 3 products



Introduction

The company has continued to make progress in a number of areas, most notably in the acceptance by a growing number of 'original equipment' printer manufacturers (OEMs) of our newer technologies (Platform 2 and Platform 3). Sales of 'developer kits' for these products, the precursor to commercial printer launch, have continued to grow as planned.

However, volume sales of our more mature products into China (Platform 1) have not met our expectations, resulting in total revenues being 4% lower than the same period last year. Nevertheless profit before tax has increased by 20% for the period and the overall cash position remains strong. Work continues towards reducing our dependence on mature products and single markets.

Furthermore, as indicated in the period-end trading update in July 2008, after more than 18 months of discussion and detailed negotiations, we were highly disappointed not to be able to conclude a major commercial agreement as planned during the first half of the year. These discussions were ended due to adverse economic conditions affecting the third party and not for technical reasons.

Results

Revenues for the six months ending 30 June 2008 were £22.5m (six months to 30 June 2007: £23.4m). The continuing efforts to reduce manufacturing costs, and our foreign currency hedging programme providing some protection against the strengthening of the Swedish kronor against sterling in the period, have improved gross margins to 58% in the half year, an increase from the 52% achieved for the whole of 2007. Profit before tax for the period was £3.8m (30 June 2007: £3.1m), after providing for amortisation of capitalised R&D of £0.5m (30 June 2007: £0.5m) and the cost of share-based payments of £0.5m (30 June 2007: £0.4m). As usual the majority of sales were products at £20.6m (30 June 2007: £22.4m). Royalty income increased to £1.6m (30 June 2007: £0.8m) whilst, as expected, development fees remained

Despite the current uncertainties, we have an exciting opportunity that the company and its staff have the ability, resources and products with which to succeed.

CHAIRMAN'S STATEMENT

Results

immaterial at £0.3m (30 June 2007: £0.2m). Royalty growth is in part a result of the increased activity by our licensees (often in competition with Xaar) whilst development fees relate, as previously reported, primarily to completion of finite work for Agfa concerned with their commercialisation of Platform 2 technology. Earnings per share increased 25% to 4.5p (30 June 2007: 3.6p).

Cash and cash equivalents at 30 June 2008 were £10.7m (30 June 2007: £10.0m).

Business commentary

The first six months of 2008 was a period of sharp contrasts; on the one hand the welcome continuing endorsement of our Platform 2 and Platform 3 technologies by OEMs globally, and on the other hand disappointing Platform 1 sales to China. We have continued to see strong demand for our new technology development kits and sales of these are in line with our expectations. Our technology was endorsed at Drupa, the world's largest commercial printing equipment exhibition held every four years in Dusseldorf, through being showcased on numerous manufacturers' stands and the company itself having a significant presence.

Press and technology analyst comment was favourable, confirming Xaar as a leader in the field of commercial inkjet printing. Significantly, this comment substantially endorsed 'generic' inkjet as a technology for the future as the limitations of traditional, analogue printing equipment are being exposed increasingly by new requirements. Following the show we were very pleased to receive a prestigious 2008 PIA/GATF InterTech™ Award for our 1001 (Platform 3) printhead. The InterTech™ Technology Awards recognise the development of technologies predicted to have a major impact in the graphic arts and related industries.

Printer manufacturers continue to announce new products based on Xaar Platform 2 and Platform 3 technology. Interest in our new technology is widespread, with the majority of enquiries so far emanating from Western economies. Our revenues currently rely heavily on China where a significant number of the world's wide and grand format printers are now produced. Through the introduction of Platform 2 and Platform 3 products, we expect to achieve a better geographic balance to both revenues and profits in the future.

Also significant is the interest in adoption of our newer technologies by new market segments, particularly packaging and industrial applications. As well as a focus on geographic diversity we are also expanding beyond our traditional wide format graphics market where we remain the leader.

All this contrasts with our traditional business in China. Whilst other regions have performed well (Europe up 15%, Americas up 26%), sales in China have been particularly disappointing (Asia as a whole was down 19%). We believe that growth in the wide format graphics market as a whole in China has slowed significantly and this trend has been compounded by other short term impacts including the earthquake in Sichuan province, a slowing of the Chinese domestic economy and restrictive practices enforced by the Chinese government in the run-up to, and throughout the period of, the Olympics. Competitive activity by Xaar licensees based on aggressive pricing to gain market share has compounded the issue. On the positive side, as sales from our licensees have increased at the expense of our own sales, the company has derived some benefit from increased royalty payments.

Markets and technology

Significant at Drupa was the increased interest in and adoption of inkjet technology. Xaar was able to demonstrate a clear lead over its competitors by having technology that was functional, demonstrable and commercially available. As inkjet increases its functionality, speed and quality more manufacturers, in response to demand from their customers, are planning to utilise the increased flexibility offered by this digital technology.

The packaging market is of specific interest where language, content, date and coding drive a requirement for higher levels of printed variable data. We are seeing a growing demand for technology that delivers this kind of flexibility. Xaar Platform 3 technology is now deployed within a number of new commercially available digital label printing presses, including the Nilpeter Caslon and the award winning EFI Jetrion 4000.

Board changes

After many years of dedicated service, founder director and former Chairman Richard King CBE, retired at this year's AGM. Richard's vision, technology understanding and 'Cambridge connections' have all added to Xaar's growth and development over 18 years. His wise counsel was invaluable. We thank him for his contributions and wish him well for a long retirement.

Change of advisor

The board decided that it should review the company's broker and as a result of this process Landsbanki Securities (UK) Limited has been retained as the company's new financial advisor and broker. We thank Panmure Gordon for their loyalty and commitment to the company over the previous eight years.

Dividend

An interim dividend of 1.0p per share will be paid on 17 September 2008 to shareholders on the register at close of business on 29 August 2008. This will be the first interim dividend to be paid by the company; hitherto a single final dividend has been paid (2007: 2.5p).

The board now expects its dividend payment policy to be a split of approximately one-third/two-thirds between the interim and final payments, subject to performance.

Outlook

The current international economic issues are affecting the global printing market and Xaar cannot reasonably expect to be immune from this. Specifically, at the time of writing, there is a lack of visibility and increased uncertainty with regard to demand from China for our Platform 1 products over the next few months and, while the uptake of our latest technology continues its encouraging trend, the timing of product launches by our OEM customers remains difficult to predict.

For the reasons set out earlier in this report we now believe sales to China will be lower than previously expected for the second half of the year and this will have some effect on second half profitability. We will provide a further update on trading in the next Interim Management Statement which will be issued during the first two weeks of October. At that stage, the likely outcome for the year should be clearer.

We have excellent new technologies that are clearly of significant commercial value and will play a leading roll in the continuing market transition to digital inkjet printing. I therefore remain confident that, despite the current uncertainties, we have an exciting opportunity that the company and its staff have the ability, resources and products with which to succeed.



Phil Lawler

Chairman

19 August 2008

DIRECTORS' RESPONSIBILITIES

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting, as adopted by the European Union;
- the Chairman's statement includes a fair review of the information required by DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
- the Chairman's statement includes a fair review of the information required by DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during the period; and also any changes in the related party transactions described in the last annual report that could do so.



Ian Dinwoodie
Chief Executive
19 August 2008



Andrew Taylor
Finance Director

CONSOLIDATED INCOME STATEMENT

for the six months ended 30 June 2008

	Notes	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Continuing operations				
Revenue	2	22,478	23,441	47,853
Cost of sales		(9,424)	(11,092)	(22,925)
Gross profit		13,054	12,349	24,928
Distribution costs		(2,444)	(1,962)	(4,003)
Administrative expenses		(7,049)	(7,396)	(13,932)
Operating profit		3,561	2,991	6,993
Investment income		225	193	447
Finance costs		(32)	(62)	(119)
Profit before tax before share-based payments		4,241	3,553	8,275
Share-based payments		(487)	(431)	(954)
Profit before tax		3,754	3,122	7,321
Tax	5	(923)	(874)	(1,920)
Profit for the period attributable to shareholders		2,831	2,248	5,401
Earnings per share from continuing operations				
Basic	6	4.5p	3.6p	8.6p
Diluted	6	4.4p	3.5p	8.4p

Dividends paid in the period amounted to £1,530,000 (six months to 30 June 2007: £1,218,000; twelve months to 31 December 2007: £1,218,000).

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

for the six months ended 30 June 2008

	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Exchange differences on translation of foreign operations	(115)	55	(64)
Cash flow hedges transferred to income statement	—	(18)	—
Tax on items taken directly to equity	69	222	(746)
Net (loss)/income recognised directly in equity	(46)	259	(810)
Profit for the period	2,831	2,248	5,401
Total recognised income and expense for the period	2,785	2,507	4,591

CONSOLIDATED BALANCE SHEET

as at 30 June 2008

	Notes	As at 30 June 2008 (unaudited) £'000	As at 30 June 2007 (unaudited) £'000	As at 31 December 2007 (audited) £'000
Non-current assets				
Property, plant and equipment		12,763	11,886	11,849
Goodwill		720	720	720
Other intangible assets	4	6,916	7,097	7,294
Investments		2,020	2,020	2,020
Deferred tax asset		316	916	322
		22,735	22,639	22,205
Current assets				
Inventories	3	7,164	4,098	4,137
Trade and other receivables		10,325	7,041	8,511
Current tax assets		—	834	—
Cash and cash equivalents		10,723	10,033	13,036
Derivative financial instruments		263	36	261
		28,475	22,042	25,945
Total assets		51,210	44,681	48,150
Current liabilities				
Trade and other payables		(7,884)	(7,181)	(6,711)
Other financial liabilities		(204)	(191)	(198)
Current tax liabilities		(1,666)	(308)	(1,246)
Obligations under finance leases		(1)	(453)	(245)
Provisions		(143)	(164)	(193)
Derivative financial instruments		—	(18)	—
		(9,898)	(8,315)	(8,593)
Net current assets		18,577	13,727	17,352
Non-current liabilities				
Deferred tax liabilities		(1,731)	(1,635)	(1,810)
Other financial liabilities		(548)	(752)	(651)
Obligations under finance leases		—	(42)	—
		(2,279)	(2,429)	(2,461)
Total liabilities		(12,177)	(10,744)	(11,054)
Net assets		39,033	33,937	37,096
Equity				
Share capital		6,306	6,275	6,285
Share premium		10,320	10,048	10,146
Own shares		(4,465)	(4,465)	(4,465)
Other reserves		4,538	3,528	4,051
Hedging and translation reserves		414	635	529
Retained earnings		21,920	17,916	20,550
Equity attributable to shareholders		39,033	33,937	37,096
Total equity		39,033	33,937	37,096

CONSOLIDATED CASH FLOW STATEMENT

for the six months ended 30 June 2008

	Note	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Net cash from operating activities	7	1,674	3,098	8,565
Investing activities				
Purchases of property, plant and equipment		(2,010)	(2,177)	(3,823)
Proceeds on disposal of property, plant and equipment		60	—	—
Purchases of trading investments		—	(89)	(89)
Expenditure on capitalised product development		(468)	(1,084)	(1,770)
Net cash used in investing activities		(2,418)	(3,350)	(5,682)
Financing activities				
Dividends paid		(1,530)	(1,218)	(1,218)
Proceeds from issue of ordinary share capital		195	449	561
Repayments of borrowings		(97)	(107)	(201)
Repayments of obligations under finance leases		(258)	(224)	(498)
Purchase of own shares		—	(1,045)	(1,045)
Net cash outflow from financing activities		(1,690)	(2,145)	(2,401)
Net (decrease)/increase in cash and cash equivalents		(2,434)	(2,397)	482
Effect of foreign exchange rate changes		121	(8)	116
Cash and cash equivalents at beginning of period		13,036	12,438	12,438
Cash and cash equivalents at end of period		10,723	10,033	13,036

NOTES TO THE INTERIM FINANCIAL INFORMATION

for the six months ended 30 June 2008

1. Basis of preparation and accounting policies

Basis of preparation

These interim financial statements have been prepared in accordance with the accounting policies set out in the company's 2007 annual report and were approved by the board of directors on 19 August 2008. The interim financial statements for the six months ended 30 June 2008 have been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the European Union. The interim financial statements do not include all the information and disclosures in the annual financial statements, and should be read in conjunction with the group's annual financial statements as at 31 December 2007.

The financial information in these interim financial statements does not constitute statutory financial statements as defined in section 240 of the Companies Act 1985. The group's annual report for the year ended 31 December 2007 has been filed with the Registrar of Companies and the auditor's review report on those financial statements was not qualified and did not contain statements made under section 237(2) or section 237(3) of the Companies Act 1985.

The interim financial statements are unaudited but have been formally reviewed by the auditors, Ernst & Young LLP, and their report to the company is set out on page 11.

Significant accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the group's annual financial statements for the year ended 31 December 2007, except for the adoption of new Standards and Interpretations, noted below. Adoption of these Standards and Interpretations did not have any effect on the financial position or performance of the group.

IFRIC 11 and IFRS 2 Group and Treasury Share Transactions

The group has adopted IFRIC Interpretation 11 as of 1 January 2008. The interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The adoption of this interpretation did not have any effect on the financial position or performance of the group.

NOTES TO THE INTERIM FINANCIAL INFORMATION

for the six months ended 30 June 2008

2. 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 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Revenue			
Printheads and related products	20,600	22,353	45,612
Development fees	316	244	467
Licence fees and royalties	1,562	844	1,774
Total revenue	22,478	23,441	47,853

	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Result			
Printheads and related products	8,695	8,372	17,025
Development fees	(38)	(41)	(79)
Licence fees and royalties	1,316	670	1,415
Total segment result	9,973	9,001	18,361
Unallocated corporate expenses	(6,412)	(6,010)	(11,368)
Profit from operations	3,561	2,991	6,993
Investment income	225	193	447
Finance costs	(32)	(62)	(119)
Profit before tax	3,754	3,122	7,321
Tax	(923)	(874)	(1,920)
Profit after tax	2,831	2,248	5,401

Unallocated corporate expenses relate to administrative expenses which cannot be directly attributed to any of the principal product groups.

2. Business and geographical segments

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 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Revenue			
Asia	11,222	13,940	27,937
Europe and Middle East	7,843	6,800	14,235
North and South America	3,413	2,701	5,681
Total revenue	22,478	23,441	47,853

3. Inventories

During the period, the group planned and executed an increase to its finished goods inventory holding of £3.0m in order to compensate for the reduced build plan during the summer holiday period at the group's manufacturing facility in Sweden. It is anticipated that inventories will subsequently return to the levels seen throughout 2007.

4. Intangible assets

During the period the company spent £0.2m on development of a new ASIC. These costs have been capitalised on the balance sheet and will be amortised once development is complete and this is estimated to be during 2009.

5. Income tax

The major components of income tax expense in the income statement is as follows:

	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000
Current income tax:		
Income tax charge	979	1,003
Deferred income tax:		
Relating to origination and reversal of temporary differences	(56)	(129)
Income tax expense	923	874

NOTES TO THE INTERIM FINANCIAL INFORMATION

for the six months ended 30 June 2008

6. 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 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Earnings			
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	2,831	2,248	5,401
Number of shares			
Weighted average number of ordinary shares for the purposes of basic earnings per share	62,881,307	62,246,666	62,514,226
Effect of dilutive potential ordinary shares:			
Share options	1,143,744	1,729,183	1,599,424
Weighted average number of ordinary shares for the purposes of diluted earnings per share	64,025,051	63,975,849	64,113,650

7. Notes to the cash flow statement

	Six months ended 30 June 2008 (unaudited) £'000	Six months ended 30 June 2007 (unaudited) £'000	Twelve months ended 31 December 2007 (audited) £'000
Profit before tax	3,754	3,122	7,321
Adjustments for:			
Share-based payments	487	431	954
Depreciation of property, plant and equipment	1,594	1,318	2,895
Amortisation of intangible assets	692	614	1,320
(Gain)/loss on disposal of property, plant and equipment	(14)	—	12
Decrease in provisions	(50)	(45)	(16)
Operating cash flows before movements in working capital	6,463	5,440	12,486
Increase in inventories	(3,050)	(446)	(319)
Increase in receivables	(1,842)	(941)	(2,645)
Increase/(decrease) in payables	764	633	(16)
Cash generated by operations	2,335	4,686	9,506
Income taxes paid	(661)	(1,588)	(941)
Net cash from operating activities	1,674	3,098	8,565

Cash and cash equivalents (which are presented as a single class of asset on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

8. Date of approval of interim financial statements

The interim financial statements cover the period 1 January 2008 to 30 June 2008 and were approved by the board on 19 August 2008.

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

for the six months ended 30 June 2008

Introduction

We have been engaged by the company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008 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 8. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the company in accordance with guidance contained in ISRE 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" 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 half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

Ernst & Young LLP
Cambridge
19 August 2008

DIRECTORS AND ADVISORS

Phil Lawler
Chairman

Ian Dinwoodie
Chief Executive

Andrew Taylor
Finance Director

Phil Eaves
Sales and Marketing Director

Ramon Borrell
Research and Development Director

Greg Lockett
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