XAAR

1998 Report & Accounts

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Business strategy

Xaar has developed a digital ink jet printing technology with applications across the broad spectrum of the world of print. It is a versatile technology protected by a substantial portfolio of patents. Xaar has developed a range of inks which, when used in conjunction with Xaar printheads, enables printing on all kinds of surfaces, including paper, plastic, textiles, cardboard, metal, ceramic and glass.

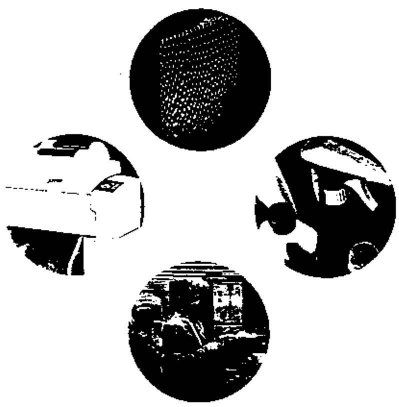
Xaar's goal is for its technology to become adopted as a mainstream printing technology of the next century.

Xaar's strategy is to commercially exploit this technology in three distinct ways:

Xaar Technology - licensing the technology to major global corporations for high volume consumer and office applications.

XaarJet - manufacturing and sale of high performance specialised printheads and inks to original equipment manufacturers ('OEMs') for commercial and industrial applications.

Xaar Digital - forming strategic alliances for the development of the next generation technology with global leaders in printhead manufacture and ink production.



Chairman's statement

1998 was a transitional year for Xaar after the considerable achievements of 1997. We continued to make sound progress on a number of technical and commercial fronts with important development agreements signed with major global corporations. However, we were not able to conclude a new licence in the year and consequently the financial results for the year are disappointing.

Business development and acquisition

As set out in our business strategy, we intend to exploit Xaar's technology in three distinct ways. Graham Wylie, in his Chief Executive's review, reports on progress in each of the areas of Xaar Technology, XaarJet and Xaar Digital. Of particular note are important development and collaboration agreements signed with Kyocera and DuPont for the page wide printhead - the next generation of the technology. In addition, we have successfully moved to our new facility on the Science Park in Cambridge with a much higher grade of cleanroom, enabling us to make the first XaarJet printhead shipments in the final quarter of 1998. Our new sales and support offices in the USA and Japan will improve our ability to penetrate new geographical markets for Xaar products.

On 12 March 1999, we were delighted to announce two further important events - the proposed acquisition of Modular Ink Technology ("MIT") for £3.4m and a strategic investment of £1.2m in new Xaar shares by Olympus Optical of Japan ("Olympus").

Based in Sweden, MIT is a leading manufacturer of ink jet printheads using Xaar technology. This is a key development for Xaar, greatly increasing our manufacturing capacity and capability in a way which complements our existing XaarJet operation in Cambridge. It will enable a broader product range of printheads and inks to be supplied to OEM customers on a world-wide basis.

Investment by Olympus

In conjunction with the acquisition of MIT, and conditional upon it, we are pleased to welcome Olympus not only as MIT's largest customer but also as a shareholder in Xaar. They will make an investment in new shares of £1.2m, for a holding of approximately 4% in Xaar plc. This is an important endorsement of both Xaar's core technology and MIT's manufacturing expertise.

Results and finance

Turnover for the year was £1.5m (1997: £4.4m). Royalty income exceeded £1m (1997: £560,000) and the first XaarJet revenues were booked in the final quarter of the year. No licence was signed however. The loss before tax reported for the year was £4.6m (1997: £100,000 profit).

During the year, capital investment (including year end commitments) was £3.0m, mostly relating to the new cleanroom manufacturing facilities in our new premises. At year end Xaar had net assets of £11.2m and cash of £8.7m.

Outlook

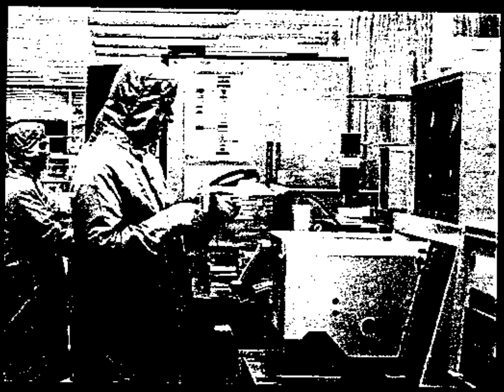
We remain confident in our strategy to exploit Xaar's technology and we believe that the foundations are being laid for long term sustained growth. Xaar operates in a large global market that is increasingly seeking new digital printing solutions and we remain well placed to meet these changing needs in a wide range of market segments.

1998 was a year in which progress was made at a slower rate than planned. However, we continue to look forward to the future with considerable confidence in our technology, our people and our strategy.

A. Rosenfeld.

Arie Rosenfeld
Chairman

16 March 1999



1998 proved to be a difficult year commercially for Xaar, although encouraging progress was made by the group on several fronts. The board continues to believe that our strategy for the growth of the company is correct. The addition to the group of MIT, in Sweden, will provide an additional base from which to increase the coverage of Xaar technology products throughout the printing industry.

Xaar business strategy

The use of ink jet printing has grown significantly over the last few years and has now found a role in all of the principal printing areas. Xaar has categorised the market for ink jet printing into established, developing and emerging markets and, with the formation of its three operating subsidiaries, Xaar is laying the foundation of a printhead technology group that will participate in office, industrial and commercial printing.

The combination of licensing for high volume applications (office and home), industrial printhead manufacture (XaarJet) and partnered supply for high speed commercial printing means that, in due course, Xaar's technology will play a major role throughout the printing industry.

Acquisition of Modular Ink Technology

The proposed acquisition of MIT will add a high grade manufacturing facility of 60,000 sq ft and an experienced workforce of some 85 people. MIT is an established manufacturer of Xaar's ink jet technology - producing over 55,000 printheads in 1998. Recently, MIT has set up an ink packaging operation which it is our intention to utilise for the whole range of XaarJet products.

We are pleased to have received the support of Jan Fineman and his local MIT management team for the acquisition by Xaar. They will play an important role in the integration of the operations.

We believe that the acquisition of MIT is complementary to our existing XaarJet operation. The two companies together will be able to provide customers with a wide choice of printheads and inks. The addition to the Xaar group of MIT will offer the potential of accelerated growth and further reduce Xaar's historical reliance on licensing revenues.

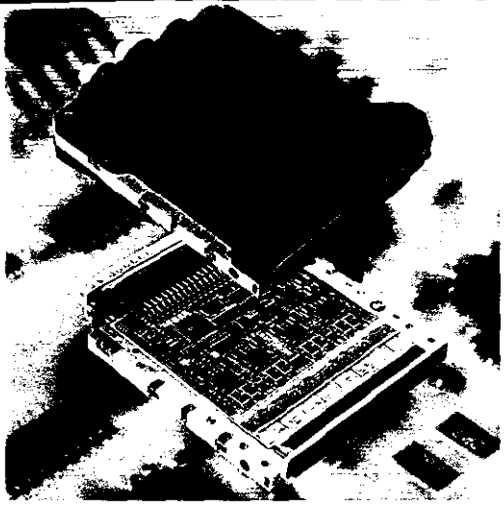
Xaar Technology Limited

Xaar Technology Limited is the subsidiary responsible for the original business of Xaar - licensing, on a non-exclusive basis, the rights to manufacture and market ink jet printheads and/or inks utilising Xaar proprietary technology.

To date, many of Xaar's licensees have been Japanese international corporations operating in the office and commercial printing markets. As has been widely observed elsewhere, 1998 was a difficult year with the slow down in the Japanese and other Far Eastern economies.

The effect on Xaar was that no new licences were signed in 1998, although many discussions were held with target companies. Existing licensees deferred the completion of product development plans which, in turn, meant that the anticipated release of new products in 1998 utilising the Xaar technology did not happen. The effect was a slow down in the rate of growth in royalties to £1m in 1998 against £560,000 for 1997. Although the growth in royalties year on year is substantial, it is not in line with our expectations of this time last year.

However, we have noted some increase in the level of enquiries from Japan in the first quarter of 1999, although the timing and size of such licence deals remains difficult to predict. Xaar has recently strengthened its presence in Japan by the appointment of a full time Japanese sales manager who will be well placed to follow up more closely the licence negotiations.



Xaar's products continue to generate strong interest from the printing industry. More sectors of the industry are now viewing ink jet as the technology that will play a major role in the future.

XaarJet Limited

XaarJet was established as a separate subsidiary in 1998 to manufacture and market XaarJet printheads to the industrial sector of the printing market.

The new manufacturing facilities were brought on stream during the last quarter of 1998. The introduction of new equipment, and in particular a new high standard cleanroom, has enabled the manufacture of the printheads to improve significantly. However, the output has still not yet reached the levels the company requires to meet current demand.

The XaarJet 500 is a 70 mm wide printhead which has a linear speed capability of around 22 inches per second. This was demonstrated at the major UK printing exhibition, IPEX, held in Birmingham in September 1998. The response to this product was extremely positive and has re-inforced the company's view that a major market exists for industrial ink jet printheads.

This printhead is acknowledged to be among the most advanced ink jet devices available today. The manufacture of such a high speed, high resolution colour printhead was anticipated to present some technical challenges. These are now being overcome and we can look forward to a much improved performance from this subsidiary in 1999.

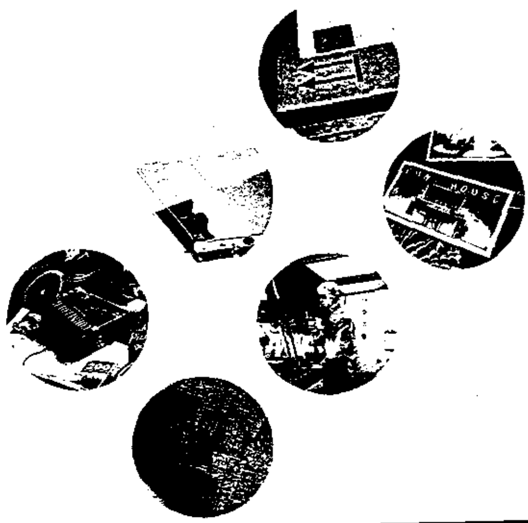
Sales and support offices have been established in the USA and Japan to promote the full range of printhead products now available from XaarJet.

An important addition to the range of printheads offered by XaarJet will come from MIT's 64 and 128 channel printheads. MIT currently has several major customers for its printheads, including Olympus, which manufactures wide format printers for Xerox. MIT has the capacity to increase output and should benefit from the group sales and marketing effort. It is our intention to upgrade the market offering of MIT as soon as possible using the manufacturing designs and techniques developed by Xaar during the XaarJet programme.

The employees of MIT have considerable experience in the manufacture of printheads using the Xaar technology. Expansion of the MIT customer base has been restricted by the difficulties encountered by its parent company during 1998. Xaar believes that there is a backlog of customer demand for MIT products that has been held up during the period of financial uncertainty at MIT. These customers will welcome the acquisition of MIT by a company prepared to invest in updating the product range. It will be Xaar's intention to improve the yield and operating performance of MIT in the short term.

Upon completion of the acquisition, MIT will be renamed XaarJet AB to reflect more accurately its role within the Xaar group.

Continued over



Xaar Digital Limited

During 1998, Xaar commenced development work on a printhead which is the width of an A4 page, which will enable colour printing at around 120 pages per minute when integrated with a suitable printing system.

In order to exploit this development commercially in the most effective way, Xaar established a new subsidiary in late 1998, Xaar Digital.

In my 1997 review I stated that Xaar believed that the development of a page wide printhead was unlikely to be achieved by Xaar alone. I am pleased to report that during 1998, Xaar signed development agreements with two important partners in the page wide printhead project.

Kyocera Corporation of Japan is a world-leader in the manufacture of precision ceramic-based products for the electronics industry. Under the terms of a collaboration agreement signed between Xaar and Kyocera, the manufacture of the page wide printhead will be undertaken on behalf of Xaar by Kyocera. It is anticipated that the first prototypes of the page wide printhead will be available later in 1999 and that the first public demonstration of the system will occur during 2000. The engineers and development staff of Xaar and Kyocera are working extremely closely on the development of the page wide printhead and early indications are that the completed product will have a major impact on the printing industry.

With a printhead designed to print at such speeds, it is necessary to have an optimised set of inks. During 1998 Xaar signed a joint development agreement with DuPont Ink Jet Inks, the world's leading manufacturer of inks for ink jet printers. Work on the formulation of new inks is proceeding satisfactorily.

Xaar Digital will be responsible for optimising the printheads and the inks which will be supplied by Kyocera and DuPont. The matched sets will then be sold to OEMs, who will integrate the printheads into printing systems.

Xaar has ongoing negotiations with potential OEM partners, all of whom are established and major market players in high speed printing.

Intellectual Property Rights

During the year Xaar issued proceedings in the UK and in the USA against CalComp Inc. for the infringement of Xaar's patents. Lockheed Martin, CalComp's parent corporation, announced recently that it was no longer prepared to financially support CalComp. As a result, CalComp is currently in the process of shutting down its operations which may or may not result in a sale of the part of its business which produced the products which were the subject of Xaar's suits.

People

During the year the board welcomed Hugh Baker-Smith, who joined as Group Sales Director to increase the company's commercial focus.

Xaar expects to make further senior appointments in 1999 as we seek to strengthen the management team to meet the challenges of converting our technical expertise into commercial success.

Xaar's management team and all its staff worked extremely hard during the year and have established the base for a much improved performance in 1999.

Graham Wylie
Chief Executive

Results for 1998

Turnover for the year was £1.5m (1997: £4.4m) with a pre-tax loss of £4.6m (1997: profit £100,000). The lack of a new licence significantly affected the financial performance of Xaar as the group currently remains dependent on licence fees as its principal revenue source. Royalty income increased to £1m, up 80% from 1997 levels; these royalties derived principally from two licensees. The final quarter of 1998 also saw the first XaarJet shipments which generated sales of £370,000.

Operating expenses

Operating expenditure increased to £7.0m in 1998 from £4.7m in 1997. This is attributable to a number of factors:

- An increase in head count with staff costs rising £750,000 to £2.8m. This was mainly recruitment for XaarJet in line with our plans. Total headcount for the group at the end of 1998 was 89, which we believe meets current requirements.

- The first full year of XaarJet operating as a stand-alone business. The majority of XaarJet expenditure was in relation to printhead design and development prior to the low volume manufacturing in the final months of 1998. Excluding staff and establishment costs, XaarJet expenditure for the year was approximately £800,000.

- As discussed in the Chief Executive's review, Xaar filed patent infringement actions against CalComp Inc. during 1998 which involved significant litigation costs in the second half of the year.

- The move to our new facilities of 22,000 sq ft on the Cambridge Science Park was completed in September 1998. The full annual cost effect of the move will be felt from 1999 onwards.

We have carefully reviewed our higher cost base going forward into 1999, and are satisfied that it is appropriate for our planned growth.

Cash and capital expenditure

Cash and liquid resources totalled £8.7m at year end (1997: £13.3m). Net assets decreased to £11.2m (1997: £15.7m) due to the loss in the period.

As planned, capital expenditure for the year was significantly higher than 1997, at £3.0m (including capital commitments for equipment delivered in early 1999). This was due to the facilities move and related to our new cleanroom, leasehold improvements and dedicated equipment for XaarJet. All our planned capital equipment is now at our new premises and fully commissioned. Our capital expenditure in 1999 will be significantly lower now that all the key requirements are in place.

Acquisition of MIT

It is intended to complete the acquisition of MIT by the end of March 1999. The net cash consideration of approximately £2.9m will be funded out of available cash reserves which stood at £8.6m at 31 January 1999. Olympus will invest £1.2m directly in Xaar upon completion of the MIT acquisition.

Year 2000

The group has a detailed plan in place to ensure, to the extent that it is possible, that the business is able to function effectively in the Year 2000 and thereafter. This plan has been reviewed and approved by the audit committee, and is focussed on business critical applications, services and equipment. The project team consists of the Finance Director and four other senior staff members, including the IT administrator.

Continued over

The team meets formally at least once a month and informally on a more regular basis, to monitor progress and actions to date. Status updates are provided to the audit committee and the board. Compliance testing, using externally sourced Year 2000 interrogation software, is well advanced, as is the written confirmation process with key equipment, application and service providers. It is planned that this project will be completed by June 1999 at the latest. Management are not expecting the costs involved in the project to exceed £10,000 (excluding internal resource costs). Upon completion of the acquisition of MIT, attention will be focussed on ensuring that the existing Year 2000 plan of MIT is fully actioned.

Financial instruments

The group's financial instruments comprise finance lease and hire purchase commitments, cash and liquid resources, and various items, such as trade debtors and trade creditors, that arise directly from its operations.

The group undertakes a limited number of foreign currency transactions in the course of operations. Where such transactions are material, the group has a policy of entering into foreign currency contracts to manage currency risk arising. This was only necessary on one occasion in 1998, in relation to a significant item of capital equipment.

It is, and has been throughout the period under review, the group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the group's financial instruments are interest rate risk and liquidity risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged since the beginning of 1998.

Interest rate risk

The group is currently funded by equity and invests its funds in short term bank deposit accounts. Limits have been set by the board in relation to maximum deposits with any one institution. No deposit exceeded three months in duration during the year.

Liquidity risk

As regards liquidity, the group's policy throughout the year has been to fund significant fixed asset purchases by finance leases repayable over a maximum period of three years. Finance lease and hire purchase commitments are the only borrowings of the group.

Euro

The group is not subject to any immediate systems or trading effects of the introduction of the Euro in 1998, as the majority of sales and purchases are currently transacted in sterling or other currencies.

J A Lowe
Finance Director

Board of directors

Executive directors

1. Graham Wylie, Chief Executive, aged 50 - has worked in senior financial and general management roles within a number of companies with particular emphasis on the computer and computer peripherals industries. He joined Xaar in 1991 as Finance Director and became Chief Executive in 1993.

2. Jonathan Lowe, Finance Director, aged 38 - qualified as an accountant with Arthur Andersen and has held senior financial positions with companies in a variety of sectors including Parkway (printing and pre-press) and Lyonnaise des Eaux (environmental services). He joined the Xaar board in 1996.

3. Stephen Temple, Technical Director, aged 51 - is one of the original inventors of the Xaar technology. His inventions and joint inventions have led to more than 80 patents covering the technology. His primary role, aside from leading the technical team, is to focus on future development. He has been a director since 1991.

4. Mark Shepherd, Business Development Director, aged 36 - is one of the original inventors of Xaar technology and has acquired a broad knowledge of the printing industry. He is a key member of the licence negotiations team, promotes the technology world-wide and is responsible for relations with licensees. He has been a director since 1994.

6. Hugh Baker-Smith, Group Sales Director, aged 35 - joined the board in November 1998 to increase the focus on concluding licence agreements and to develop XaarJet sales internationally. Hugh previously worked for Hitachi and has 14 years IT industry experience gained in a variety of sales, marketing and management roles.

Non-executive directors †

5. Arie Rosenfeld + *, Chairman, aged 55 - was until 1995 President of Scitex, which he joined shortly after its formation in 1968. Scitex is a world leader in graphic arts, digital printing and digital video products. He joined the Xaar board in February 1997 and was appointed Chairman in June 1997.

7. Robert Hook +, Director, aged 55 - is Managing Director of Prelude Technology Investments, a venture capital firm and a director of Prelude Trust plc. He has been a director of several high-technology companies, including Cambridge Positioning Systems Limited and Vocalis Group plc. A director of Xaar since 1990, he was Chairman from late 1995 until June 1997.

8. Richard King CBE +*, Deputy Chairman and senior independent director, aged 69 - is Chairman of Cadcentre Group plc, Cambridge Research & Innovation Limited, Deputy Chairman of Addenbrookes NHS Trust and a fellow of Darwin College. A director of Xaar since 1990, he was appointed Deputy Chairman of the company in September 1997, and the senior independent director in January 1999.

9. Michael Geary *, Director, aged 48 - is a director of Euroventures, a pan-European venture capital group, based in Holland. An engineer, he worked for 3i and Charterhouse, before becoming Managing Director of Munford & White plc in 1982 on its flotation. He was later founder of Prudential Venture Managers. He joined the Xaar board in 1996.

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+ Member of audit committee
* Member of remuneration committee
† All non-executive directors are considered to be independent

Directors' report for the year ended 31 December 1998

The directors present their annual report on the affairs of the group together with the financial statements and auditors' report for the year ended 31 December 1998.

Principal activity and business review

The principal activity of the group continues to be the development and commercial exploitation of a patented ink jet printing technology. A detailed review of the group's operations during the year and of its plans for the future is given in the Chairman's Statement and the Chief Executive's review. The subsidiary undertakings of the group are listed in note 23 to the financial statements.

Research and development

A significant proportion of the group's employees are involved in research and development and £3.4m (1997: £3.4m) was spent on research and development in the year.

Results and dividends

Turnover for the year was £1.5m (1997: £4.4m) and comprises licence fees, royalties and sales of printheads and related products. The loss after tax for the year was £4,636,000 (1997: £213,000). The directors do not recommend the payment of a dividend (1997: nil).

Directors and their interests

The directors who served throughout the year, except as noted below, were as follows: -

G. T. Wylie
J. A. Lowe
S. Temple
M. R. Shepherd
H. Baker-Smith (appointed 17 November 1998)
A. Rosenfeld
R. A. King
M. J. Geary
R. C. Hook

Brief biographical descriptions of the directors and their membership of certain board committees are set out on page 9. Full details of their interests in the shares of the company and its subsidiary undertakings are included in the remuneration report on pages 14 to 17.

In accordance with the company's articles of association, at the Annual General Meeting referred to in more detail on page 36, Messrs King and Lowe will retire from the board by rotation and offer themselves for re-election. Additionally, Mr Baker-Smith is seeking election by shareholders for the first time.

Substantial shareholdings

As at 11 March 1999 the company had been notified in accordance with sections 198 to 208 of the Companies Act 1985, of the following material interests in its share capital:

	Number of ordinary shares held	*Percentage of issued share capital*
Prelude Technology Fund II Limited Partnership	8,268,870	15.9%
Fidelity International Limited	5,143,850	9.9%
3i plc	4,558,120	8.8%
Sofipa[1]	3,159,840	6.1%
Mountcashel plc	1,933,330	3.7%
Dainippon Screen Manufacturing Company Limited	1,680,000	3.2%

1. Sofipa includes the interests of Societa Finanziaria di Partecipazione S.p.A. and Sofipa International SA.

Annual General Meeting

Notice of the meeting is given on page 36. Resolutions 1 to 5 set out in the notice of the meeting deal with the ordinary business to be transacted at the meeting. The special business of the meeting (Resolutions 6 and 7) is explained below.

Power to issue securities

Resolution 6

Under the Companies Act 1985 the directors of the company may only allot shares (whether for cash or otherwise) with the authority of shareholders given at a general meeting of the company. Under Resolution 6 authority is sought to allot shares up to an aggregate nominal amount of £1,621,043, which is expected to represent the whole of the unissued share capital as at 31 March 1999. The directors do not currently have an intention to exercise the authority, other than (a) the allotment of up to 3,337,140 ordinary shares in the company to be issued in exchange for ordinary shares of Xaar Technology Limited acquired by the company pursuant to a put and call mechanism in the articles of association of Xaar Technology Limited (such Xaar Technology Limited shares will be issued on the exercise of options over Xaar Technology Limited shares) and (b) the allotment of 435,870 ordinary shares pursuant to previous contractual commitments.

Resolution 7

This special resolution will give the directors power under the company's articles to allot shares for cash on a non-pre-emptive basis in the following circumstances:

(a) in connection with a rights issue, open offer or otherwise to holders of ordinary shares but allowing the directors to make adjustments to deal with practical problems such as those arising from fractional entitlements or compliance with overseas legislation; and

(b) up to a maximum aggregate nominal value of £260,051, representing 5 per cent. of the issued ordinary share capital of the company as at 16 March 1999 otherwise than as described in (a) above.

Although non-pre-emptive issues of shares for cash of up to 5 per cent. of the company's issued share capital is permitted by this resolution, the directors have no current intention to issue any shares for cash on a non-pre-emptive basis, other than 435,870 shares (representing 0.8 per cent. of the issued share capital) to be issued pursuant to previous contractual commitments.

The authorities contained in Resolutions 6 and 7 will expire no later than 15 months after the passing of those resolutions.

Charitable contributions

The group made charitable contributions during the year totalling £250 (1997: £200).

Supplier payment policy

The group's and the company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment.

There were no trade creditors in the balance sheet of the company at 31 December 1998 (1997: nil).

Post balance sheet event

The post balance sheet event is set out in note 25 to the consolidated financial statements.

Auditors

The directors will place a resolution before the Annual General Meeting to reappoint Arthur Andersen as auditors for the ensuing year.

Science Park
Cambridge
CB4 0XR
16 March 1999
Registered no. 3320972

By order of the Board

J A Lowe
Secretary

Corporate governance statements

In June 1998 the Hampel Committee and the London Stock Exchange published the Combined Code on corporate governance. This combines the Cadbury Code on corporate governance, the Greenbury Code on directors' remuneration and new requirements arising from the findings of the Hampel Committee.

Statement of compliance with the Code of Best Practice

The company has complied throughout the year with the Provisions of the Code of Best Practice set out in section 1 of the Combined Code, except for the following matters:

- Richard King was not formally appointed as the senior independent director until 19 January 1999. In practice, this has not changed his role within the board.
- In accordance with previous guidance, the framework of executive remuneration was determined by the remuneration committee independently of the board. In accordance with the Combined Code, with effect from 19 January 1999, the remuneration committee is to make recommendations to the board on the framework of executive remuneration. The remuneration committee will, however, continue to determine specific remuneration packages for executive directors on behalf of the board.
- No board members received any formal training during the year, however it has now been agreed formal training will be held at least annually. There has only been one board appointment in 1998, Hugh Baker-Smith, and he has received detailed briefings from the Chief Executive and the Finance Director regarding his responsibilities and role as a director.

Statement about applying the Principles of Good Governance

The company has applied the Principles of Good Governance set out in section 1 of the Combined Code by complying with the Code of Best Practice as described above. Further explanation of how the Principles have been applied is set out below and, in connection with directors' remuneration, in the remuneration report.

Board of directors

The executive directors of the company are fully involved with the management of the group at all levels, and the direction and control of the company remains firmly in their hands. The board is fully involved in the nomination, selection and appointment of non-executive and executive directors, although there is no formal written procedure in place.

The board comprises the non-executive Chairman, five executive and three non-executive directors, including the senior independent director, and meets at least ten times during the year. It is responsible for the business and commercial strategy, monitoring progress, the approval of major transactions and the approval of financial statements and operating and capital expenditure budgets. A nomination committee for board appointments has not been established, because the full board are actively involved in all appointments. There is currently no intention to form a nomination committee given the board's current size.

Audit committee

The audit committee comprises three of the non-executive directors, Arie Rosenfeld, Richard King and Robert Hook, and is chaired by the senior independent director, Richard King. It examines and reviews, on behalf of the board, internal financial controls, financial and accounting policies and practices, the form and content of financial reports and statements, and the work of the external auditors. The Chief Executive and the Finance Director attend meetings of the audit committee by invitation.

Remuneration committee

The remuneration committee comprises three of the non-executive directors, Arie Rosenfeld, Richard King and Michael Geary and is chaired by the senior independent director, Richard King. It makes recommendations to the board on the group's policy for executive remuneration, and determines the individual remuneration packages on behalf of the board for the executive directors of the group. The Chief Executive attends meetings by invitation. The committee has access to professional advice, both inside and outside the company, in the furtherance of its duties.

Constructive use of AGM

The board used the AGM held on 21 April 1998 as an opportunity to present to shareholders an overview of Xaar's business model and strategy. Further presentations will be made at future AGM's.

Internal financial control

The board of directors has overall responsibility for ensuring that the group maintains a system of internal financial control to provide them with reasonable assurance regarding the reliability of financial information used by the business and for publication, and that assets are safeguarded. There are inherent limitations in any system of internal financial control and, accordingly, even the most effective system can provide only reasonable, and not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets.

The directors have limited their comments regarding the group's system of internal control to internal financial controls, as permitted by the London Stock Exchange, pending publication of guidance for directors on the broader aspects of internal control. The key procedures that have been established and that are designed to provide effective internal financial control are described below:

- the operation of the audit committee within the terms of reference described above;
- clearly defined and segregated organisational responsibilities and limits of authority;
- well defined financial controls and procedures including information systems implemented across the group;
- monthly reporting of financial information to the board, including comment, comparison to budgets and periodic re-forecasting; and
- established procedures relating to acquisitions, disposals and material capital expenditure.

The Combined Code requires that the framework of internal financial control is reviewed on, at least, an annual basis. The directors have performed such a review during the year. As far as the directors are aware, there have been no weaknesses in internal financial control that have resulted in any material losses, contingencies or uncertainties requiring disclosure in the financial statements.

Remuneration report

Remuneration report

As well as complying with the Provisions of the Code as disclosed in the company's corporate governance statements, the board has applied the Principles of Good Governance relating to directors' remuneration as described below.

Remuneration committee

The principal function of the remuneration committee (the membership of which is outlined in the corporate governance statements) is to determine, on behalf of the board, the specific remuneration and other benefits of all executive directors, including pension contributions, bonus payments, share options and service contracts. The fees paid to the non-executive directors are determined by the board. Additionally, the remuneration committee makes recommendations to the board on the framework of executive remuneration.

Total level of remuneration

The remuneration committee is aware that it must both attract and retain individuals of the highest calibre by offering remuneration competitive with comparable publicly listed companies, and fairly and responsibly reward individuals for their contribution to the success of the company.

Basic salaries

The basic salary of each executive director is determined by taking into account the individual's performance and responsibilities, and the achievement of personal objectives.

Bonus payments

Bonuses are non-pensionable and based on a percentage of basic salary. Bonuses are paid in recognition of each executive director's contribution to the success of the company and upon achievement of certain corporate and personal targets. Non-executive directors do not receive a bonus.

Pension scheme

The company operates a self-administered, defined contribution, Inland Revenue approved pension scheme. All current executive directors participate in this scheme. Non-executive directors do not receive pension contributions.

Share options

All executive directors are entitled to participate in the company's share option schemes. Any options granted thereunder are approved by the remuneration committee. Except for the Chairman, non-executive directors do not currently participate in the company's share option schemes. It is the policy of the company to grant share options to employees and executive directors as a means of encouraging ownership and providing incentives for performance.

Terms of appointment

Executive directors' appointments are terminable by 12 months' written notice. Non-executive directors' appointments are terminable by 6 months' written notice.

Directors' remuneration

The remuneration of directors who served during the year was as follows:

Director	*Basic salary £'000*	*Fees £'000*	*Benefits in kind £'000*	*Bonus payments £'000*	*Money purchase pension contributions £'000*	***Total 1998 £'000***	*Total (including pension contributions) 1997 £'000*	*Money purchase pension contributions 1997 £'000*
Executive:								
G. T. Wylie	95	—	11	—	8	**114**	118	7
J. A. Lowe	82	—	9	—	7	**98**	116	5
S. Temple	78	—	6	—	9	**93**	96	8
M. R. Shepherd	70	—	8	—	7	**85**	77	5
H. Baker-Smith	9	—	3	4	1	**17**	—	—
Non-executive:								
A. Rosenfeld	—	36	—	—	—	**36**	36	—
R. A. King	—	24	—	—	—	**24**	16	—
R. C. Hook[1]	—	18	—	—	—	**18**	20	—
M. J. Geary	—	18	—	—	—	**18**	14	—
	334	96	37	4	32	**503**	493	25

1. These fees are paid to Prelude Technology Investments Limited, of which R.C. Hook is Managing Director.

Remuneration report

Directors' share options

Directors' emoluments disclosed above do not include any amounts for the value of options to acquire ordinary shares in the company granted or held by the directors. Details of the options are as follows:

Name	*As at 1 January 1998*	*Granted*	*Exercised/ Lapsed*	*As at 31 December 1998*	*Gain on exercise 1998 £*	*Exercise price*	*Earliest date of exercise*	*Expiry date*
G. T. Wylie	43,300	—	—	43,300	—	15p	31.08.95	31.08.99
	389,730	—	—	389,730	—	15p	01.02.96	01.02.00
	148,680	—	—	148,680	—	15p	14.09.96	14.09.00
	106,880	—	—	106,880	—	15p	28.02.97	28.02.01
	100,000	—	—	100,000	—	15p	04.07.98	04.07.02
	700,000	—	—	700,000[6]	—	15p	17.10.97	21.03.03
	11,079	—	(11,079)[2]	—	—	88p	01.12.00	01.06.01
	—	19,375[7]	—	19,375	—	50p	20.10.01	20.04.02
	1,499,669			1,507,965				
S. Temple	43,300	—	—	43,300	—	15p	31.08.95	31.08.99
	389,730	—	—	389,730	—	15p	01.02.96	01.02.00
	101,250	—	—	101,250	—	15p	28.02.97	28.02.01
	170,000	—	—	170,000	—	15p	09.05.99	09.05.02
	11,079	—	—	11,079[2]	—	88p	01.12.00	01.06.01
	715,359			715,359				
M. R. Shepherd	21,650	—	—	21,650	—	15p	31.08.95	31.08.99
	194,870	—	—	194,870	—	15p	01.02.96	01.02.00
	161,250	—	—	161,250	—	15p	28.02.97	28.02.01
	70,000	—	—	70,000	—	15p	04.07.98	04.07.02
	120,000	—	—	120,000	—	15p	09.05.99	09.05.02
	11,079	—	(11,079)[2]	—	—	88p	01.12.00	01.06.01
	—	19,375[7]	—	19,375	—	50p	20.10.01	20.04.02
	578,849			587,145				
J. A. Lowe	200,000	—	—	200,000[3]	—	48p	01.11.99	01.11.03
	200,000	—	—	200,000[3]	—	48p	01.01.00	01.01.04
	100,000	—	—	100,000[3]		48p	28.04.00	28.04.04
	100,000	—	—	100,000[3]	—	48p	26.06.00	26.06.04
	11,079	—	(11,079)[2]	—	—	88p	01.12.00	01.06.01
	—	19,375[7]	—	19,375	—	50p	20.10.01	20.04.02
	611,079			619,375				
H. Baker-Smith	—	201,620[8]	—	201,620	—	62p	20.10.01	20.10.05
	—	48,380[8]	—	48,380	—	62p	20.10.01	20.10.08
	—	19,375[7]	—	19,375	—	50p	20.10.01	20.04.02
	—			269,375				
A. Rosenfeld	500,000	—	(500,000)[4]	—	14,000	48p	17.10.97	17.10.98
	500,000	—	(500,000)[4]	—	—	48p	17.10.97	17.10.98
	—	800,000[5]	—	800,000	—	62p	01.01.00	30.09.01
	1,000,000			800,000				

Notes:

1. All outstanding options granted to Messrs Wylie, Temple and Shepherd (other than those granted under the Share Save Schemes and those under a separate option agreement to Mr Wylie) are in fact options held over shares in Xaar Technology Limited, a wholly owned subsidiary of Xaar plc acquired as a result of a share for share exchange on 14 September 1997. These options are held under the Xaar Technology Limited 1992 Unapproved Scheme; however, upon exercise, a put and call mechanism in the articles of association of Xaar Technology Limited provides for immediate conversion to shares in Xaar plc and therefore the figures in the above table assume such conversion.
2. These options were granted under the Xaar plc 1997 Share Save Scheme and lapsed during the year upon take up of the Xaar plc 1998 Share Save Scheme in the case of Messrs Wylie, Shepherd and Lowe.
3. These options were granted under the Xaar Technology Limited 1997 Unapproved Scheme. Mr Lowe has exchanged these options for options over Xaar plc shares.
4. On 17 October 1998, Mr Rosenfeld exercised 100,000 of the options granted in 1996 at an exercise price of 48p (the mid market price on 16 October 1998 and 19 October 1998 was 62p). The remaining balance of 900,000 lapsed.
5. These options were granted to Mr Rosenfeld under a separate option agreement which provides for exercise between 1 January 2000 and 30 September 2001.
6. This is a separate option agreement with Mr Wylie, under the terms of which the options became exercisable on 17 October 1997, the date of the admission of the company to the Official List, and lapse seven years after the date of grant.
7. These options were granted under the Xaar plc 1998 Share Save Scheme.
8. These options were granted to Mr Baker-Smith on 20 October 1998. Mr Baker-Smith was appointed to the board on 17 November 1998.

Gains on exercises of share options in 1997 were made by Messrs Wylie (£200,000), Temple (£200,000), Shepherd (£100,000) and King (£174,000).

The market value of the ordinary shares of the company as at 31 December 1998 was 56p per share. The closing mid range price ranged from 161p to 50p per share during the year.

Directors' interests

The interests in the shares of the company and its subsidiaries as at 31 December 1998 of the directors who held office during the year are as follows:

Shareholdings in the company

	No. of ordinary shares of 10p each 31 Dec 1998	*No. of ordinary shares of 10p each 31 Dec 1997*
G. T. Wylie	122,840	122,840
J. A. Lowe	—	—
S. Temple	105,140	105,140
M. R. Shepherd	69,390	69,390
H. Baker-Smith	—	—
A. Rosenfeld	100,000	—
R. A. King	318,580	318,580
M. J. Geary	—	—
R. C. Hook	—	—

There have been no changes in the directors' interests in shares of the company between 31 December 1998 and 11 March 1999.

Statement of directors' responsibilities

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the company and of the group, and of the profit or loss of the group for the period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going concern

After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

To the Shareholders of Xaar plc

We have audited the financial statements on pages 20 to 35 which have been prepared under the historical cost convention and the accounting policies set out on pages 23 to 24. We have also examined the amounts disclosed relating to the emoluments, share options and pension benefits of the directors which form part of the remuneration report on pages 14 to 17.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including, as described on page 18, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We review whether the statement on page 12 reflects the company's compliance with those provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the company's corporate governance procedures or its internal controls.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company and of the group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group at 31 December 1998 and of the group's loss and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

Arthur Andersen

Chartered Accountants and Registered Auditors

Betjeman House

104 Hills Road

Cambridge

CB2 1LH

16 March 1999

Consolidated profit and loss account for the year ended 31 December 1998

	Notes	1998 £'000	1997 £'000
Turnover	2	**1,504**	4,371
Operating expenses (net)	3	**(6,957)**	(4,738)
Operating loss		**(5,453)**	(367)
Interest receivable	4	**870**	390
Interest payable and similar charges	5	**(43)**	81
(Loss)/profit on ordinary activities before taxation	6	**(4,626)**	104
Tax on (loss)/profit on ordinary activities	8	**(10)**	(317)
Retained loss for the financial year	17	**(4,636)**	(213)
Loss per share – basic	10	**(8.9p)**	(0.5p)

There were no recognised gains or losses except for the loss for the periods and therefore no statement of total recognised gains and losses has been provided.

All operations of the group continued throughout both periods and no operations were acquired or discontinued.

A statement of movements on reserves is given in note 17.

The accompanying notes are an integral part of this consolidated profit and loss account.

Consolidated balance sheet as at 31 December 1998

	Notes	1998 £'000	1997 £'000
Fixed assets			
Tangible assets	11a	**3,430**	1,381
Investments	11b	**20**	20
		3,450	1,401
Current assets			
Stocks	12	**38**	—
Debtors	13	**1,214**	2,624
Cash and liquid resources	21	**8,739**	13,297
		9,991	15,921
Creditors: amounts falling due within one year	14	**(2,030)**	(1,335)
Net current assets		**7,961**	14,586
Total assets less current liabilities		**11,411**	15,987
Creditors: amounts falling due after more than one year	15	**(227)**	(285)
Net assets		**11,184**	15,702
Capital and reserves			
Called-up share capital	16	**5,201**	5,159
Share premium account	17	**9,111**	9,048
Other reserves	17	**938**	925
Accumulated deficit	17	**(4,066)**	570
Shareholders' funds - all equity	18	**11,184**	15,702

Signed on behalf of the Board
16 March 1999

G T Wylie
Director

J A Lowe
Director

The accompanying notes are an integral part of this consolidated balance sheet.

Consolidated cash flow statement for the year ended 31 December 1998

	Notes	1998 £'000	1997 £'000
Net cash (outflow) from operating activities	19	**(3,485)**	(1,958)
Returns on investments and servicing of finance	20	**851**	257
Capital expenditure and financial investment	20	**(1,744)**	(393)
Cash (outflow) before management of liquid resources and financing		**(4,378)**	(2,094)
Management of liquid resources	20	**4,287**	(9,600)
Financing	20	**(180)**	9,816
(Decrease) in cash in the year	21	**(271)**	(1,878)

The accompanying notes are an integral part of this consolidated cash flow statement.

1. Accounting policies

The principal accounting policies, all of which have been applied consistently throughout the year and the prior year are set out below:

a) *Basis of accounting*

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards.

b) *Basis of consolidation*

The company has accounted for Xaar Technology Limited under merger accounting principles and the company's consolidated profit and loss accounts for the periods prior to the merger have therefore been prepared as though Xaar Technology had been a subsidiary throughout these periods.

XaarJet Limited, a wholly owned subsidiary of the company, has been consolidated using acquisition accounting principles.

c) *Tangible fixed assets*

All fixed assets are shown at original historical cost net of depreciation and any provision for impairment.

Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its estimated useful life, as follows:

Improvements to leasehold property	10 years
Plant and machinery	3 – 5 years
Furniture, fittings and equipment	3 – 5 years
Motor vehicles	3 years

d) *Investments*

Fixed asset investments are shown at cost less provision for impairment.

e) *Stocks*

Stocks are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and an attributable proportion of manufacturing overheads based on normal levels of activity. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal. Provision is made for obsolete, slow-moving or defective items where applicable.

f) *Foreign currency*

Transactions denominated in foreign currencies are recorded in the local currency at actual exchange rates as of the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the year end are reported at the rates of exchange prevailing at the year end or, if appropriate, at the forward contract rate. Gains or losses arising from a change in exchange rates subsequent to the date of the transactions are included as exchange gains or losses in the profit and loss account.

g) *Research and development*

Research and development costs, including the costs associated with the acquisition, registration and development of patents and know-how, are written off to the profit and loss account as incurred.

h) *Pension costs*

Amounts charged in the profit and loss account comprise employer's contributions payable to the company's group personal pension scheme in respect of pensionable payroll costs for the accounting year.

i) *Turnover*

Turnover, all of which arises from continuing activities, comprises licence fees receivable under agreements (gross of any tax withheld), royalties receivable, and sales of printheads and related products net of trade discounts, VAT and other sales related taxes.

j) *Leases*

Assets held under finance leases are initially capitalised at the fair value of the asset with an equivalent liability categorised as appropriate under creditors due within or after one year. The asset is depreciated over the shorter of the lease term and its useful economic life. Finance charges are allocated to accounting periods over the period of the lease to produce a constant rate of charge on the outstanding balance. Rentals are apportioned between finance charges and reduction of the liability, and allocated to operating expenses.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis.

1. Accounting policies (continued)

k) *Taxation*

Corporation tax payable is provided on taxable profits at the current rate.

Foreign tax payable in the year is written off, except when recoverability against corporation tax payable is considered to be reasonably assured.

Deferred taxation (which arises from differences in the timing of the recognition of items, principally depreciation, in the accounts and by the tax authorities) is calculated on the liability method. Deferred tax is provided on timing differences, which will probably reverse at the rates of tax likely to be in force at the time of reversal. Deferred tax is not provided on timing differences which, in the opinion of the directors, will probably not reverse.

2. Segment information

Turnover by class of business:

	1998 £'000	*1997 £'000*
Licence fees	**125**	3,420
Royalties	**1,011**	558
Printheads and related products	**368**	—
Consultancy and other	—	393
	1,504	4,371

Turnover by geographical segment:

	1998 £'000	*1997 £'000*
Europe	**959**	741
Rest of World	**545**	3,630
	1,504	4,371

All turnover originates in the UK. No additional segmental information is provided on the basis that it would be seriously prejudicial to the interests of the group.

3. Operating expenses (net)

	1998 £'000	*1997 £'000*
Research and development costs	**3,437**	3,359
Selling and administration costs	**2,465**	1,379
Manufacturing and engineering costs	**1,055**	—
	6,957	4,738

4. *Interest receivable*

	1998	*1997*
	£'000	*£'000*
Interest receivable on short term deposits	**870**	390

5. Interest payable and similar charges

	1998	*1997*
	£'000	*£'000*
Bank loans and overdrafts	**—**	7
Finance leases and hire purchase contracts	**43**	37
Write back of interest on other loans	—	(125)
	43	(81)

6. (Loss)/profit on ordinary activities before taxation

The (loss)/profit on ordinary activities before taxation is stated after charging/(crediting):

	1998	*1997*
	£'000	*£'000*
Auditors' remuneration		
– audit	**23**	20
– non audit	**55**	36
Depreciation		
– owned	**355**	267
– held under finance leases and hire purchase contracts	**224**	173
Staff costs (see note 7)	**2,768**	2,011
Operating lease rentals		
– *plant and machinery*	***6***	12
– land and buildings	**191**	135
Profit on sale of tangible fixed assets	**(9)**	(1)
Government grant income	**(24)**	(37)
Exceptional write back of loan	—	(65)

Notes to the consolidated financial statements

7. Staff costs

Particulars of employees (including executive directors) are shown below:

	1998	*1997*
	£'000	*£'000*
Employee costs during the year amounted to:		
Wages and salaries	**2,336**	1,732
Social security costs	**236**	167
Other pension costs	**196**	112
	2,768	2,011

The average monthly number of persons employed by the group was as follows:

	1998	*1997*
	Number	*Number*
Research and development	**32**	47
Sales and marketing	**12**	9
Manufacturing and engineering	**32**	—
Administration	**10**	7
	86	63

Remuneration of directors

The remuneration report on pages 14 to 17 includes details of directors' emoluments, which form part of these financial statements.

8. Tax on (loss)/profit on ordinary activities

The tax charge is based on the (loss)/profit for the year and comprises:

	1998	*1997*
	£'000	*£'000*
Foreign withholding taxation	**10**	317

No deferred tax has been provided due to the availability of tax losses carried forward of approximately £6.5m (1997: £2.5m).

9. Loss attributable to Xaar plc

The loss for the financial year dealt with in the accounts of Xaar plc was £529,000 (1997: profit £172,000). As provided by section 230 of the Companies Act 1985, no profit and loss account is presented in respect of Xaar plc.

10. Loss per share – basic

The calculation of loss per share is based on the loss for the financial year and on the weighted average number of ordinary shares in issue during the year of 51,904,762 (1997: 42,369,000).

11a. Tangible fixed assets

	Leasehold property	Plant & machinery	Furniture, fittings & equipment	Motor vehicles	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 1998	167	2,109	253	219	2,748
Additions	827	1,410	297	111	2,645
Disposals	(167)	(502)	(119)	(68)	(856)
At 31 December 1998	827	3,017	431	262	4,537
Depreciation					
At 1 January 1998	167	1,007	106	87	1,367
Charge for the period	20	401	98	60	579
Disposals	(167)	(502)	(119)	(51)	(839)
At 31 December 1998	20	906	85	96	1,107
Net book value					
At 31 December 1998	**807**	**2,111**	**346**	**166**	**3,430**
At 31 December 1997	—	1,102	147	132	1,381
Leased assets included in the above:					
Net book value					
At 31 December 1998	**—**	**490**	**15**	**138**	**643**
At 31 December 1997	—	594	—	116	710

11b. Investment in own shares

An Employee Benefit Trust was established in 1995 to hold shares for the benefit of the employees of the company and the group. Xaar Trustee Limited was formed during 1995 to act as trustee to the Trust. At 31 December 1998 and 1997 there were 91,250 ordinary shares in Xaar plc held in trust by Xaar Trustee Limited at a cost of £20,000 (1997: £20,000)

12. Stocks

	1998	*1997*
	£'000	*£'000*
Raw materials and consumables	**13**	—
Work-in-progress	**7**	—
Finished goods and goods for resale	**18**	—
	38	—

13. Debtors

	1998	*1997*
	£'000	*£'000*
Trade debtors	**433**	1,965
VAT	**110**	63
Prepayments and accrued income	**671**	596
	1,214	2,624

Notes to the consolidated financial statements

14. Creditors: amounts falling due within one year

	1998	1997
	£'000	*£'000*
Obligations under finance leases and hire purchase contracts	**279**	260
Trade creditors	**1,138**	428
Taxation and social security	**92**	82
Amount due to pension scheme	**22**	13
Accruals	**499**	552
	2,030	1,335

15. Creditors: amounts falling due after more than one year

	1998	1997
	£'000	*£'000*
Obligations under finance leases and hire purchase contracts, due between 2 to 5 years	**227**	285

16. Called-up share capital

	1998	1997
	£'000	*£'000*
Authorised		
70,000,000 ordinary shares of 10p each	**7,000**	7,000
Allotted, called-up and fully paid		
52,010,248 (1997: 51,586,448) ordinary shares of 10p each	**5,201**	5,159

The movement during the year on the company's allotted, called-up and fully paid shares was as follows:

	1998	1997
	£'000	*£'000*
At 1 January 1998	**5,159**	—
Consideration for Xaar Technology Limited[1]	**25**	4,016
Placing on admission to the Official List	**—**	1,023
Exercise of share options	**17**	120
At 31 December 1998	**5,201**	5,159

1. *Relates to the exercise of Xaar Technology Limited share options which are subject to a put and call mechanism, whereby each £1 ordinary Xaar Technology share option exercised and* allotted is exchanged for ten 10p ordinary shares in Xaar plc.

16. Called-up share capital (continued)

Options have been granted under separate share option schemes to subscribe for ordinary share of the company as follows:

Scheme	*Date of grant*	*Number of shares under option*	*Subscription price per share*
Xaar Technology Limited	31 August 1992	70,440	15p
1992 Unapproved	1 Feb 1993	1,215,320	15p
Scheme (see note (i) below)	1 May 1993	101,120	15p
	14 Sept 1993	148,680	15p
	28 Feb 1994	500,320	15p
	4 July 1995	170,000	15p
	1 August 1995	141,260	15p
	9 May 1996	290,000	15p
		2,637,140	
Option Agreement (see note (ii) below)	21 March 1996	700,000	15p
Xaar Technology Limited	11 Feb 1997	738,210	48p
1997 Unapproved	28 April 1997	100,000	48p
Scheme (see note (iii) below)	26 June 1997	385,000	48p
		1,223,210	
Option Agreement (see note (iv) below)	20 Oct 1998	800,000	62p
Xaar plc 1997 Share	24 Oct 1997	75,000	110p
Option Scheme	20 Oct 1998	570,000	62p
		645,000	
Xaar plc 1997 Share Save Scheme	17 Oct 1997	56,761	88p
Xaar plc 1998 Share Save Scheme	20 Oct 1998	638,366	50p
Total		**6,700,477**	

Options under the Xaar Technology Limited 1992 Unapproved Scheme, the Xaar Technology Limited 1997 Unapproved Scheme and the Xaar plc 1997 Share Option Scheme are exercisable within three to seven years after the date of the grant, except that approved options granted under the Xaar plc 1997 Share Option Scheme are exercisable within three to ten years after the date of the grant. The maximum value of approved options, under the Xaar plc 1997 Share Scheme, which may be granted to individual employees is £30,000.

Options under both the Xaar plc Share Save schemes are exercisable between 36 and 42 months after the date of the grant.

Options under the separate option agreement with A. Rosenfeld are exercisable between 1 January 2000 and 30 September 2001 as indicated in note (iv) below.

(i) Options under this scheme are in fact options over Xaar Technology Limited shares. However, as a put and call mechanism provides for immediate conversion to Xaar plc shares upon exercise, the figures included in the above table assume such conversion.

(ii) This is a separate option agreement with G. T. Wylie, under which the options became exercisable on 17 October 1997, the date of the admission of the company to the Official List, and lapse seven years after the date of grant.

(iii) Holders of the options under this scheme have exchanged their options for options in Xaar plc.

(iv) This is a separate option agreement with A. Rosenfeld under the terms of which the options are exercisable between 1 January 2000 and 30 September 2001.

Notes to the consolidated financial statements

17. Capital and reserves

The movement on reserves for the year is as follows:

	Called-up share capital £'000	Share premium account £'000	Accumulated deficit £'000	Other reserves £'000	**Total £'000**
At 1 January 1998	5,159	9,048	570	925	**15,702**
Retained loss for the financial year	—	—	(4,636)	—	**(4,636)**
Shares issued during the year	42	63	—	13	**118**
At 31 December 1998	**5,201**	**9,111**	**(4,066)**	**938**	**11,184**

The share premium account and other reserves are not distributable. Other reserves represent the share premium account in Xaar Technology Limited.

18. Reconciliation of movements in group shareholders' funds

	1998 £'000	1997 £'000
Loss for the financial year	**(4,636)**	(213)
New shares issued	**118**	11,437
Cost of shares issued	**—**	(1,182)
Net (decrease)/increase shareholders' funds	**(4,518)**	10,042
Opening shareholders' funds	**15,702**	5,660
Closing shareholders' funds	**11,184**	15,702

19. Reconciliation of operating loss to net cash (outflow) from operating activities

	1998 £'000	1997 £'000
Operating loss	**(5,453)**	(367)
Depreciation charge	**579**	440
Profit on sale of tangible fixed assets	**(9)**	(1)
(Increase) in stock	**(38)**	—
Decrease/(increase) in debtors	**1,411**	(2,718)
Increase in creditors	**25**	753
Write-back of loan	**—**	(65)
Net cash (outflow) from operating activities	**(3,485)**	(1,958)

20. Analysis of cash flows

	1998 £'000	1997 £'000
Returns on investments and servicing of finance		
Interest received	**894**	302
Interest paid	**—**	(7)
Interest element of finance lease rentals	**(43)**	(38)
Net cash inflow	**851**	257
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(1,770)**	(406)
Sale of tangible fixed assets	**26**	13
Net cash outflow	**(1,744)**	(393)
Management of liquid resources		
Decrease/(increase) in treasury deposits	**4,287**	(9,600)
Net cash inflow/(outflow)	**4,287**	(9.600)
Financing		
Issue of ordinary share capital	**118**	10,255
Investment in own shares	**—**	(9)
Capital element of finance lease rental payments	**(298)**	(230)
Repayment of unsecured loan	**—**	(200)
Net cash (outflow)/inflow	**(180)**	9,816

21. Analysis and reconciliation of net funds

	1 January 1998 £'000	Cash flow £'000	Other non-cash changes £'000	31 December 1998 £'000
Cash at bank and in hand	297	(271)	—	**26**
Finance leases	(545)	298	(259)	**(506)**
Current asset investments	13,000	(4,287)	—	**8,713**
Net funds	12,752	(4,260)	(259)	**8,233**

	1998 £'000	1997 £'000
(Decrease) in cash in the period	**(271)**	(1,878)
Cash outflow from decrease in lease financing	**298**	430
Cash (outflow)/inflow from (decrease)/increase in liquid resources	**(4,287)**	9,600
Change in net funds resulting from cash flows	**(4,260)**	8,152
Debt written back	**-**	190
New finance leases	**(259)**	(316)
Movement in net funds in period	**(4,519)**	8,026
Net funds at beginning of period	**12,752**	4,726
Net funds at end of period	**8,233**	12,752

Cash and liquid resources comprise:

	1998 £'000	1997 £'000
Cash at bank and in hand	**26**	297
Treasury deposits	**8,713**	13,000
	8,739	13,297

22. Guarantees and other financial commitments

a) Capital commitments

At the end of the year, capital commitments were:

	1998 **£'000**	1997 £'000
Contracted for but not provided for	**329**	160

b) Lease commitments

The group has entered into non-cancellable leases in respect of fixtures, fittings and equipment, the payments for which extend over a period of up to 3 years. The total rental for the year was £6,000 (1997: £12,000).

In addition, the group leases land and buildings. The rental for the year was £191,000 (1997: £135,000).

The minimum annual rentals under non-cancellable operating leases are as follows:

	Property		*Fixtures & fittings*	
	1998 **£'000**	1997 £'000	**1998** **£'000**	1997 £'000
Operating leases which expire:				
– within 1 year	—	147	**3**	5
– between 2-5 years	—	—	**9**	7
– after 5 years	**343**	343	—	—

23. Subsidiary undertakings

The following entities are wholly-owned subsidiary undertakings of the company:

Name & country of incorporation	*Registered office*	*Issued & fully paid up share capital*	*Proportion of ordinary share capital held by the company*
Xaar Technology Limited England and Wales	Science Park, Cambridge CB4 0XR	4,111,609 ordinary £1 shares	100%
XaarJet Limited England and Wales	Science Park, Cambridge CB4 0XR	2 ordinary £1 shares	100%
Xaar Trustee Limited[1] England and Wales	Science Park, Cambridge CB4 0XR	2 ordinary £1 shares	100%
Xaar Digital Limited England and Wales	Science Park, Cambridge CB4 0XR	1 ordinary £1 shares	100%

1. Xaar Trustee Limited shares are held by Xaar Technology Limited.

The principal activity of Xaar Technology Limited is licensing, on a non-exclusive basis, the rights to manufacture and market printheads and/or inks utilising Xaar ink jet printing technology. The principal activity of XaarJet Limited, which commenced in 1998, is the manufacture and marketing of specialist Xaar printheads and inks. Xaar Digital Limited, which was formed in September 1998, did not trade during the year. No subsidiary undertakings were excluded from the consolidation.

24. Financial instruments

The finance review on pages 7 to 8 provides an explanation of the role that financial instruments have had during the period in creating or changing the risks the group faces in its activities. The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS13"). Certain financial assets such as investments in subsidiaries are excluded from the scope of these disclosures. As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures.

Interest rate profile

The group has no financial assets, other than fixed rate deposits of £8,713,000, which are part of the financing arrangements of the group. Included in this amount was £313,000 in respect of a US dollar deposit, held in relation to a specific capital expenditure commitment. The weighted average rate of interest in respect of the sterling deposits was 6.6%, and was 5.3% in respect of the US dollar deposit. The weighted average period to maturity for which these rates were fixed was 20 days in respect of the sterling deposits and 6 days with respect to the US dollar deposit. No individual deposits exceed three months in duration.

The group's financial liabilities, totalling £506,000 at 31 December 1998, and solely comprising finance leases and hire purchase commitments, are all fixed rate sterling agreements with a weighted average interest rate of 8.9%. The weighted average period to maturity in respect of these finance lease and hire purchase obligations is two years.

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December 1998 was as follows:

	Borrowings (notes 14 and 15) £'000
In one year or less	279
In more than one year but not more than two years	170
In more than two years but not more than five years	57
In more than five years	—
Total	506

Borrowing facilities

The group had no borrowing facilities at 31 December 1998.

Fair values

There is no material difference between the book value and fair value of the group's financial instruments.

Gains and losses on hedges

No unrecognised gains or losses existed at 31 December 1998 in respect of the group's financial instruments, except in relation to the US dollar account, which will be used to meet a specific US dollar capital expenditure commitment.

Market price risk

The group's exposure to market price risk comprises interest rate and foreign currency risk exposures. Group funds are invested in deposit accounts with the objective of maintaining a balance between accessibility of funds and competitive rates of return. In practice, this has meant that no deposits were made with a maturity date greater than three months during the year. Foreign currency risk exposures were not significant during the year due to the majority of sales and purchases being conducted in sterling.

25. *Post balance sheet event*

On 12 March 1999 the company conditionally agreed to acquire the whole of the issued share capital of Modular Ink Technology i Stockholm AB. The total consideration of approximately £3.4m comprises £2.9m cash and forgiveness of royalties due to the group amounting to approximately £500,000.

• Company balance sheet as at 31 December 1998

	Notes	1998 £'000	1997 £'000
Fixed asset investments	1	**4,112**	4,086
Current assets			
Debtors	2	**1,401**	103
Cash at bank and in hand		**8,747**	12,111
		10,148	12,214
Creditors: amounts falling due within one year	3	**(305)**	(1,921)
Net current assets		**9,843**	10,293
Net assets		**13,955**	14,379
Capital and reserves			
Called-up share capital	4	**5,201**	5,159
Share premium account	4	**9,111**	9,048
Accumulated deficit	4	**(357)**	172
Shareholders' funds – all equity	4	**13,955**	14,379

Signed on behalf of the Board
16 March 1999

G T Wylie
Director

J A Lowe
Director

The accompanying notes are an integral part of this balance sheet.

1. Fixed asset investments

Subsidiary undertakings

	1998 £'000	1997 £'000
At 1 January 1998	**4,086**	—
Acquisition of Xaar Technology Limited[1]	**26**	4,086
Acquisition of XaarJet Limited[2]	**—**	—
Acquisition of Xaar Digital Limited[2]	**—**	—
At 31 December 1998	**4,112**	4,086

1. The company, pursuant to the put and call provisions in the articles of association of Xaar Technology Limited, acquired the shares issued as a result of the exercise of Xaar Technology options during the year and, in consideration for their acquisition, issued ten ordinary 10p shares in the company for each £1 ordinary share so acquired.

2. The issued share capital of XaarJet Limited and Xaar Digital Limited acquired by the company during the year is set out in note 23 to the consolidated financial statements.

2. Debtors

	1998 £'000	1997 £'000
Amounts owed by group undertakings	**1,332**	—
VAT	**6**	15
Prepayments and accrued income	**63**	88
	1,401	103

3. Creditors: amounts falling due within one year

	1998 £'000	1997 £'000
Amounts owed to group undertakings	—	1,759
Taxation and social security	**4**	—
Accruals	**301**	162
	305	1,921

4. Capital and reserves

	Called-up share capital £'000	Share premium account £'000	Accumulated deficit £'000	Total £'000
At 1 January 1998	5,159	9,048	172	**14,379**
New shares issued	42	63	—	**105**
Loss for the financial year	—	—	(529)	**(529)**
At 31 December 1998	**5,201**	**9,111**	**(357)**	**13,955**

Full details of movements in share capital are given in note 16 to the consolidated financial statements.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the SECOND ANNUAL GENERAL MEETING of the company will be held at Xaar plc, Science Park, Milton Road, Cambridge, CB4 0XR on 20 April 1999 at 9.30am for the following purposes:

ORDINARY BUSINESS

1. To receive the company's annual financial statements for the financial year ended 31 December 1998, together with the directors' report and the auditors' report on those accounts.

2. To reappoint Arthur Andersen as auditors to hold office from the conclusion of this meeting until the conclusion of the next general meeting of the company at which accounts are laid and to authorise the directors to fix their remuneration.

3. To reappoint Richard Ashton King as a director in accordance with the company's articles of association.

4. To reappoint Jonathan Alexander Lowe as a director in accordance with the company's articles of association.

5. To reappoint Hugh Baker-Smith as a director in accordance with the company's articles of association.

SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolutions which will be proposed in the case of resolution 6 as an ordinary resolution and in the case of resolution 7 as a special resolution:

6. THAT in substitution for all existing authorities the authority conferred on the directors by article 4(B) of the company's articles of association be renewed for the period expiring 15 months after the date of the passing of this resolution and for that period the "section 80 amount" is £1,621,043.

7. THAT subject to the passing of resolution 6, the power conferred on the directors by article 4(C) of the company's articles of association be renewed for the period expiring 15 months after the date of the passing of this resolution and for that period the "section 89 amount" is £260,051.

BY ORDER OF THE BOARD

J A Lowe
SECRETARY

16 March 1999

NOTES

1. A member entitled to attend and vote at the meeting is also entitled to appoint one or more proxies to attend and, on a poll, vote instead of him. The proxy need not be a member of the company.

2. To be effective, the instrument appointing a proxy and any authority under which it is executed (or a notarially certified copy of such authority) must be deposited at the office of the company's registrars not less than 48 hours before the time for holding the meeting. A form of proxy is enclosed with this notice. Completion and return of the form of proxy will not preclude ordinary shareholders from attending and voting in person.

3. In accordance with Regulation 34 of the Uncertified Securities Regulations 1995, the company specifies that only those members entered on the register of members of the company as at 9.30 am on 18 April 1999 (or in the event the meeting is adjourned, on the register of members 48 hours before the time of any adjourned meeting) shall be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries on the register of members after 9.30 am on 18 April 1999 (or in the event the meeting is adjourned, on the register of members less than 48 hours before the time of any adjourned meeting) shall be disregarded in determining the rights of any person to attend or vote at the meeting.

4. Copies of directors' service agreements and the register of directors' interests kept by the company under section 325 of the Companies Act 1985 will be produced at the commencement of the meeting and remain open and accessible during the continuance of the meeting to any person attending the meeting.

5. Biographical details of all directors offering themselves for re-election are set out on page 9.

Company information and advisers

Registered Office	Science Park Cambridge CB4 0XR
Secretary	Jonathan Lowe
Financial advisor and lead broker	Nomura International plc Nomura House 1 St. Martin's-le-Grand London EC1A 4NP
Joint broker	Greig Middleton & Co. Limited 30 Lombard Street London EC3V 9EN
Registered auditors	Arthur Andersen Betjeman House 104 Hills Road Cambridge CB2 1LH
Solicitors	Clifford Chance 200 Aldersgate Street London EC1A 4JJ
Bankers	Barclays Bank plc 15 Bene't Street Cambridge CB2 3PZ
Registrars	IRG plc Balfour House 390/398 High Road Ilford Essex IG1 1NQ