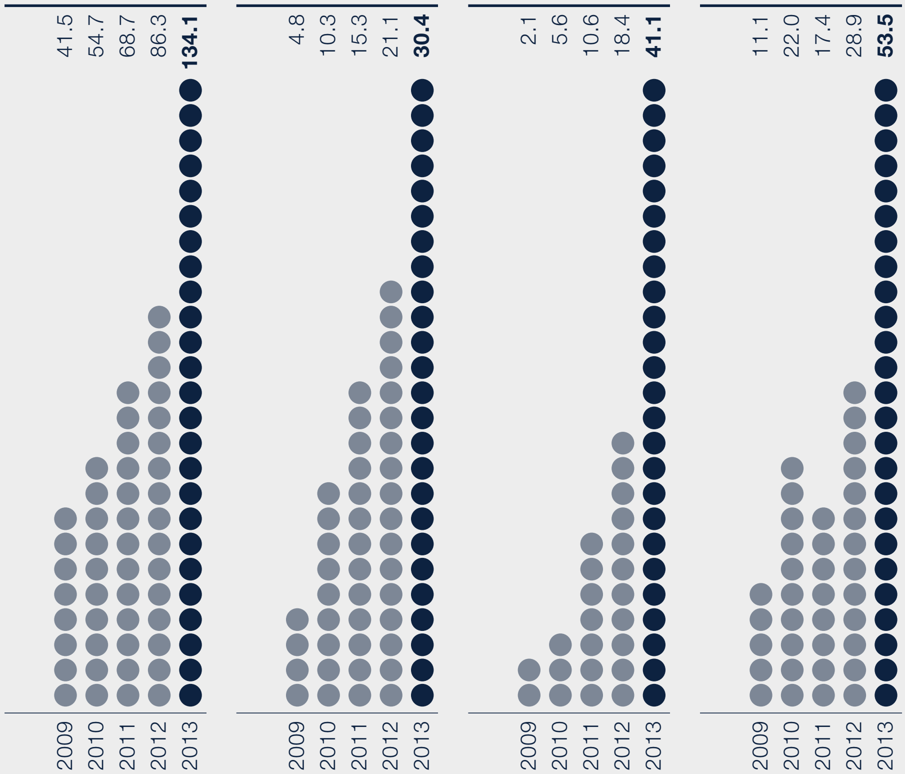
Xaar plc
Annual Report and Accounts 2013

XAAR®

At the centre of the digital inkjet revolution

Highlights

- Record revenue, growing 55% over 2012 and more than trebling over the last four years.
- Exceptional performance in the Industrial sector, driven primarily by the continued conversion of the global ceramic tile market and strong demand for Xaar's market-leading technology.
- Profit before tax and earnings per share (EPS) more than doubled. Full year dividend doubled.
- Presently mid-way through a £30 million investment programme to increase production capacity at the Huntingdon manufacturing facility by 75%.
- 43% increase in year-end headcount with nearly 800 employees at 31 December 2013, including over 650 jobs in the UK.
- Investment in research and development (R&D) doubled to £16.4 million (12% of revenue) with R&D headcount increasing by 64% year on year.



Adjusted measures exclude items from the IFRS results, such as share-based payment charges, exchange differences relating to Swedish operations, unrealised gains/losses on derivative financial instruments, non-recurring royalty income, R&D expenditure credit impairment on trade investments, commercial agreement costs, and restructuring costs, per the reconciliation of adjusted financial measures on page 75. Net cash includes cash and cash equivalents, treasury deposits, less obligations under loan and finance lease liabilities.

Our history

1990
Xaar is formed in Cambridge to acquire, develop and commercially exploit a new digital inkjet printing technology arising out of work done by Cambridge Consultants Ltd. Xaar's business concentrates on licensing four granted patents and know-how to printer manufacturers, primarily for use in office applications.

1996
Revenue from licence sales hits £1.5 million.

1997
Xaar completes a successful listing on the London Stock Exchange. The flotation raises a total of £15 million after expenses. Of this, £10 million represents new capital for the Company to accelerate development of the Group.

1999
Xaar acquires MIT, an existing licensee. MIT is integrated into Xaar and becomes Xaar's dedicated manufacturing facility at Järfälla, Sweden. Xaar's product portfolio is expanded considerably through the acquisition.

2003
Xaar introduces its first full production printhead incorporating its unique, patented greyscale technology. The Xaar 318 is manufactured in Japan by Xaar licensee Toshiba TEC and offers photographic-quality printing with no compromise in speed.

2005
Revenue of over £40 million achieved as this first application of Grand/Wide Format Graphics converts to digital inkjet.

2006
Xaar invests £6 million in a new manufacturing plant in Huntingdon.

A world leader in the development of inkjet technology and manufacture of piezoelectric drop-on-demand industrial inkjet printheads

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2006
Xaar launches the revolutionary Xaar 1001 printhead with TF Technology™ delivering a significant step forward in inkjet reliability. Xaar is confirmed as a market-leader in the innovation of digital inkjet printing.

2009
Five label presses are launched demonstrating the Xaar 1001's high quality, single-pass printing capability.

2010
£14 million is raised, after expenses, through placing an open offer to fund the £22 million capacity expansion at the Huntingdon facility to meet growing demand for the Xaar 1001 in the ceramics market.

2011
Xaar completes a second consecutive year above 25% sales growth through the adoption of the Xaar 1001 by the ceramics and label printing sectors.

2012
Xaar records a third consecutive year of revenue growth in excess of 25%, and posts a 74% increase in annual profits. The capacity expansion programme at Huntingdon successfully completes ahead of schedule and below budget.

2013
Ceramics conversion accelerates, driven by adoption of the technology in China. Progress in the packaging segment, particularly labels and direct-to-shape. Further capital investment is undertaken to increase capacity by a further 75% by mid-2014 versus the status at the end of 2012.

The digital inkjet opportunity

3 trillion m^2

Over 3 trillion m^2 of material is printed, patterned, decorated or finished each year – that's roughly equivalent to the surface area of India.

Most things we come into contact with on a daily basis are patterned, decorated, printed or finished in some way. In fact, even after excluding printing in the office or the home, over 3 trillion m^2 of material is printed, patterned, decorated or finished each year – that's roughly equivalent to the surface area of India.

These items can be broadly split into four areas: products, packaging, promotion and publishing. Products includes things like ceramic tiles and laminate flooring. Packaging includes labels on bottles and bar codes on boxes. Promotion includes advertising banners and posters. Publishing includes books and newspapers.

Perhaps surprisingly around 97% of production processes used in the manufacture of these items still use traditional analogue technology. Analogue (sometimes referred to as 'fixed image') solutions can be very effective when the same image is replicated many, many times. However, where frequent changes are required or run lengths are shorter, then digital (also known as 'variable image') processes can provide significant cost and inventory reduction whilst improving time-to-market versus analogue techniques.

Over the last 20 years digital imaging technologies, including digital inkjet, have emerged for applying images, patterns or finishes in more efficient, flexible and cost-effective ways. Because of its ability to work with a variety of jetting fluids and substrates, and in difficult environments, inkjet has the unique ability to potentially replace all current printing techniques.

The pace of inkjet's adoption and the rate it displaces existing technologies is driven by some key factors, including cost, speed and image quality, which must be met in order for the adoption to take place. Because of these characteristics the adoption of inkjet has typically occurred through 'waves of conversion' in distinct market segments, as the developing technology meets the individual conversion requirements of particular applications.

Xaar, a world leader in industrial inkjet, has successfully developed digital technology and manufactured and sold inkjet products, predominantly printheads, into a number of sectors. The printhead is the heart of the digital process, depositing fluids, including inks and coatings, in precisely the right quantity and in the right place on the substrate, without even touching the surface.

To date Xaar has driven, and benefited from, 'waves of conversion' in two particular applications: outdoor advertising (including billboards, posters and banners) and ceramic tile decoration, which have both adopted digital inkjet technology. These two applications presently use inkjet to annually produce over 7 billion m^2, but represent only 0.2% of the 3 trillion m^2 entire global print production.

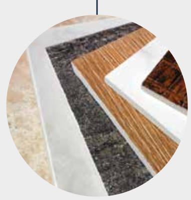
Xaar's challenge is to expand its existing digital inkjet printhead technology into new markets and to develop new technology to maximise the opportunity that exists from the conversion of much larger applications to digital inkjet.

Looking forward, the opportunities for digital print continue to develop, with industry forecasts projecting that the conversion to digital over the next 10 years is expected to be twice that seen over the last 20 years.

97%

Around 97% of production processes used in the manufacture of these items still use traditional analogue technology.

Products includes things like ceramic tiles and laminate flooring. Packaging includes labels on bottles and bar codes on boxes. Promotion includes advertising banners and posters. Publishing includes books and newspapers.



20 years

Over the last 20 years digital imaging technologies, including digital inkjet, have emerged for applying images, patterns or finishes in more efficient, flexible and cost-effective ways.

7bn m²

The graphics and ceramics sectors presently use inkjet to annually produce over 7 billion m² of products.

The printhead is the heart of the digital print process.

Xaar, a world leader in inkjet, has successfully developed digital technology and manufactured and sold inkjet products, predominantly printheads, into a number of sectors. To date, only 3% of the commercial and industrial print market has converted to digital printing, including 1% to digital inkjet.

Xaar's challenge is to expand its existing digital inkjet printhead technology into new markets and to develop new technology to maximise the opportunity that exists from the conversion of much larger applications to digital inkjet.

Our business at a glance

Xaar is a world leader in the development of inkjet technology and a manufacturer of piezoelectric drop-on-demand industrial inkjet printheads, the key component in a digital printing system. Unlike analogue printing, digital printing requires no physical master image to copy from, and hence enables economic short run, or variable data, printing. The printhead is the device which converts the electronic image data into the physical image on the substrate. To achieve this, Xaar technology is a combination of high speed mixed signal electronics, micro-mechanics, and fluid dynamics.

Our flagship printhead is the Xaar 1001, but our full range includes numerous other printheads. A typical industrial inkjet machine could be firing up to 300 million drops of ink per second – that's over 1 trillion drops per hour, all controlled within the picolitre range of volume and the micron range of placement accuracy (a picolitre is a millionth of a millionth of a litre, and a micron is a millionth of a metre).

Xaar sells its technology in component form (the printhead) to Original Equipment Manufacturers (OEMs) who produce and sell the end digital printing product to the end market. In addition to our close engagement with OEMs we also actively partner and co-develop with fluid suppliers, hardware and software integrators, and substrate suppliers to deliver a robust and attractive total solution to the end user.

Our technology is used all over the world in a wide range of manufacturing applications.

We design and manufacture our printheads in the UK and Sweden, exporting over 90% of our production to customers around the world. We also develop and sell ink systems, electronics, and fluid optimisation services to accelerate inkjet system development and adoption.

Industrial

The Industrial sector presently includes ceramic tile decoration, decorative laminate, and advanced/additive manufacturing processes.

Revenue

£98.2m

2012: £55.0m

Contribution to 2013 adjusted revenue

73%

2012: 64%

Packaging

The Packaging sector presently includes primary labels, secondary labels, coding and marking, and direct-to-shape printing.

Revenue

£15.7m

2012: £12.0m

Contribution to 2013 adjusted revenue

12%

2012: 14%

Graphic Arts

The Graphic Arts sector presently includes Grand/Wide-format graphics.

Revenue

£13.3m

2012 £13.1m

Contribution to 2013 adjusted revenue

10%

2012: 15%

Ceramic tile production

Ceramics is a 10.5 billon m^2 market currently and digital conversion was estimated to be around 40% at the end of 2013. There are c.10,000 production lines around the world, with almost half of these in China. Decoration is the key feature which sells the tile. Xaar digital inkjet solution provides an end result which is superior in terms of image quality, at a lower cost, plus with the advantages of flexibility, inventory reduction, and larger tile size capability. Tile manufacturing operates in a harsh industrial environment with high reliability/duty cycle requirements; hence any technology deployed needs to be appropriately robust. The market has been moving to digital inkjet decoration over the last ten years but the pace of change has recently accelerated significantly because the Xaar 1001 with TF Technology™ delivers both quality and cost advantages over traditional analogue methods within a robust architecture suitable to this harsh environment.

Decorative laminates

Decorative laminates is estimated to be at 7.9 billon m^2 of annual output with c.1,600 production lines around the world supplying simulated wood materials to the furniture and building industries. Decoration is often the key feature which sells the board/plank/finished item and digital quality is now being demonstrated which matches the analogue process, thereby offering the opportunity for more economic short run work to be undertaken whilst reducing inventories and improving time to market. Inkjet is the only digital solution which meets the high reliability and high duty cycle requirements needed within this industry. Digital adoption is still at the very early stages in this application, and the rate of adoption is expected to grow over the next few years.

Advanced/additive manufacturing

Applications include demand for the fine coating, patterning and printing of functional fluids onto numerous substrates in numerous industries. The square meterage of these types of applications is smaller than many mainstream printing processes; however, the value of the fluid deposition process is considerably higher. Applications are challenging and push inkjet to its known limits and beyond in fields such as nano imprinting, solar cell manufacturing and display screen production. Xaar has been working with multiple partners in laboratories all over the world exploring what may be possible in the future. Technical progress is promising but volume commercial implementation of many of these applications is still believed to be some years into the future.

Coding and marking

Coding and marking is an application of printing predominantly monochrome bar codes and logos on outer case/secondary packaging of consumer goods. This is an established and stable business based on bulk piezo which competes with alternative technologies including laser and thermal inkjet.

Primary label

Primary label printing is estimated to be a market producing over 55 billion m^2 annually, with only 5% of this market converted to digital printing to date. The change driver is the delivery of lower cost per copy on run lengths up to 100,000 impressions (versus only 50,000 impressions 3 years ago). There is a large range of substrates and inks in this application which adds complication to the conversion process; however, over the past year progress in this space is clear.

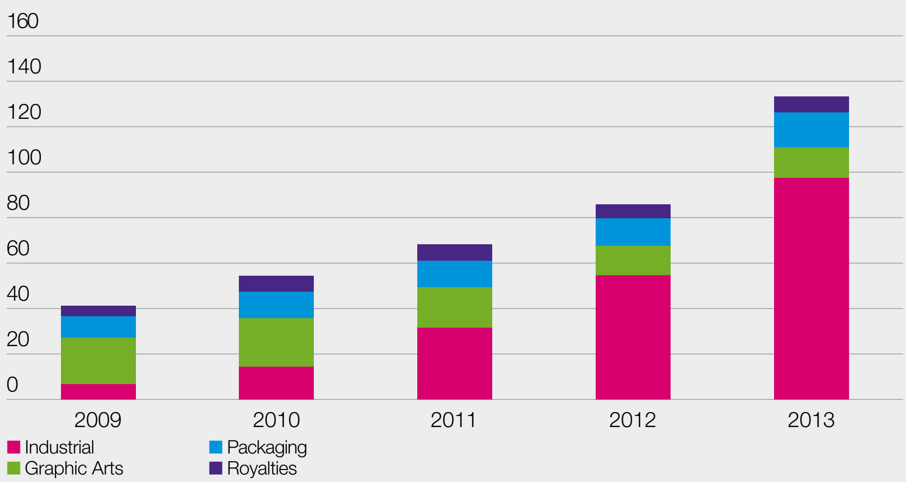
Direct-to-shape

Direct-to-shape is a new application where the bottles and containers are directly imaged without the need for a label. This emerging sector will undergo first field trials during 2014. The solution is aimed at shortening time to market whilst simultaneously reducing inventory and unit costs versus existing methods. This approach also enables mass customised marketing and event targeting.

Grand/Wide-format graphics

Grand/Wide-format graphics (GWFG) includes both internal and external signage and advertising, including billboards, posters and point of sale advertising. It is the most mature industrial inkjet market, active for over 15 years. Xaar's growth to date has been based on its original set of bulk piezo products, which delivered annual growth from 2003 to 2007. To stimulate further material growth for Xaar new product developments are required to enhance the portfolio, the first of which is expected to launch during 2014.

Adjusted revenue £m



Well placed in a growing market

Phil Lawler
Chairman
18 March 2014

I am delighted to report on a year of significant progress in our business during the 12 months ended 31 December 2013. Continuing the theme from my 2013 Interim Report, we have continued to deliver excellent financial results, whilst investing heavily for the future. All of our investments during the period in additional staff, facilities, and assets have been self-funded. Due to the substantial rise in our market capitalisation we were pleased to be admitted to the FTSE 250 in June 2013.

We have grown our revenue in each of our markets such that we achieved record revenue in the year, growing 55% over 2012 and more than trebling revenue over the last four years. Adjusted profit before tax has more than doubled over 2012, which was itself a 74% increase over 2011. Adjusted diluted earnings per share has also more than doubled to 43.2p in 2013 (2012: 20.1p), this being the fourth year in a row of substantial earnings growth. We continue to generate cash despite the investments referred to above and ended 2013 with net cash (cash and cash equivalents and treasury deposits) of £53.5 million and no debt resulting in a very strong balance sheet.

Sales into the industrial sector continue to account for a high proportion of our revenues, driven primarily by the continued conversion of the global ceramic tile market and success of Platform 3 (P3) products. Other applications in the sector, including decorative laminates and additive manufacturing, continue to make good early stage progress, albeit generating modest revenues to date. The packaging market continues to be a key focus area for the Company, and during the year we achieved strong growth in the primary label application. It was also pleasing to see the first public demonstrations of 'direct-to-shape' printing technology during the second half of the year and we will continue to work with our OEM partners in this space to support the field trials of the technology during 2014. Sales into the graphics market continue to be dominated by our older generation of products; this will be addressed by the launch of a new generation product during 2014 which is intended to re-start growth in this market.

Our excellent profit performance has been achieved as a result of extremely high asset and people utilisation. In order to bring utilisation back to standard levels and create the opportunity for further growth we are investing £30 million in manufacturing assets at the Huntingdon facility to generate an additional 75% manufacturing capacity for the Xaar 1001/2 product, which is scheduled to be in place by mid-2014. The dramatic, but virtually trouble free, increase in output during 2013 could not have been achieved without the dedication and talent of the Xaar Operations team.

During this rapid growth phase we have continued to hire talent globally. Whilst the majority of hires have been from the UK, the specialised nature of our business and our desire to employ only the best means that we have attracted people from around the world and have built a truly multi-national team of approximately 800 staff. Our Huntingdon manufacturing site has increased staff by 57% during 2013. Additionally, we have increased research and development (R&D) staff by 64% and this has required us to take a third building on the Cambridge Science Park.

I reserved comment on our new thin film piezo technology (Platform 4) deliberately until after mentioning the significant additional investment we are making in R&D. We anticipate that our bulk piezo technology has a strong future, but we know that there is plenty of opportunity for a new supplementary technology

‘We have grown our revenue in each of our markets such that we achieved record revenue in the year.’

with different attributes. Progress has been made during 2013 culminating in a successful internal technology demonstration in December 2013. We remain on track with our plan to deliver the first thin film product commercially in late 2016. Our plans are ambitious and therefore come with risks. However, as a global leader in this very large but highly segmented market, we believe this is unquestionably the right decision.

Xaar’s consistent approach is one of delivery and we have deliberately chosen to be relatively low profile. However, it was pleasing during one week in November 2013 to receive the following awards:

- ‘Main Stock Market Company of the Year’ – Shares Magazine
- ‘Tech Growth Business of the Year’ – UK Tech Awards
- ‘UK Manufacturing Site of the Year’ – National Microelectronics Institute

Additionally, in March 2014 Xaar plc won ‘Company of the Year’ for 2013 at the PLC Awards.

These awards are a testament to the increased standing the Group has achieved, due entirely to the high quality and dedication of its management and staff.

Xaar’s continuing financial performance and increased net cash in 2013 has enabled the Board to recommend a final dividend of 5.5 pence. This, together with the 2.5 pence interim dividend paid on 4 October 2013, equals 8 pence for the year, a doubling of the total dividend paid for 2012.

There were no changes to Board membership during 2013; however, due to the significant growth of the Company there will be changes during 2014. Due to the significantly enlarged scale of the R&D function, the Board has decided to appoint a Chief Technical Officer (CTO) and I am delighted to announce that Edmund Creutzmann will join the Board as CTO on 1 April 2014. Edmund brings over 30 years of digital printing R&D expertise to the Company following an extensive career at Siemens AG and Océ Printing Systems GmbH. Reporting to the CTO the R&D function has been split into two departments, with R&D 1 focusing on bulk piezo technology products (Platform 1, 2, 3) and R&D 2 focusing on thin film technology products (Platform 4). Ramon Borrell, previously R&D Director, will become Director of R&D 2, and a new hire, Brian James, will head up R&D 1. As a consequence Ramon Borrell will step down from the Board effective 1 April 2014, allowing him to concentrate all his efforts on the critical task of successfully bringing Platform 4 to market. We welcome Edmund to the Board and thank Ramon for all his contributions as R&D Director. We look forward to his success on the thin film programme. A second planned change to the Board anticipated for 2014 is the recruitment of an additional experienced Non-Executive Director to bring organisational development experience to the Board as well as improving the balance of Executive to Non-Executive Board membership.

After 12 years of dedication and focus to Xaar, Ian Dinwoodie, CEO, has informed the Board of his intention to retire during 2015. Ian has overseen the significant development of the Company, with an adjusted diluted earnings per share of 1.6 pence when he took over as CEO in 2003, growing to a record 43.2 pence in 2013. An extensive search will now be undertaken for Ian’s successor.

The annual report and accounts have been re-designed for 2013 to provide a more focused and useful document to readers of the accounts, giving a good understanding of both the opportunities and risks faced by the Group. This is in line with recommendations from the Combined Code and best practice. The Group continues to comply with the UK Corporate Governance Code 2010. Board meetings are supported by detailed papers and timely minutes. Attendance by all members remains excellent and I take this opportunity to thank them for their continuing commitment, professionalism and, above all this year, results. The Board continues to take dedicated days to consider and review the Group’s strategy. Detailed market and competitive analysis is undertaken in advance and the future direction and capabilities of the Group are debated in detail. The Board, its Executives, Chairman and Non-Executives are all evaluated annually against specific and relevant performance criteria.

Whilst 2013 has been an excellent year of progress for the Company, and the next period is expected to be more modest in terms of growth, we believe we are still very much at the start of the analogue to digital print transformation and as such we continue to see significant opportunities ahead.

Chief Executive's statement

A clear strategy for growth

Ian Dinwoodie
Chief Executive
18 March 2014

2013 has been an exceptional year for Xaar and represents the fourth year in a row of substantial growth in both revenue and profits for the Company. This year's excellent financial performance has been mainly driven from the acceleration of the adoption of Xaar's market-leading technology in the Chinese ceramic tile market and good progress in the development of the packaging market. Sales growth has been enabled by a rapid ramp in output from the Huntingdon facility which has been working at well over 100% of its standard capacity for the majority of the year.

Two important investment decisions were taken during 2013. Firstly, we began a programme to further increase capacity at the Huntingdon site to ensure that growth over the next few years would not be restricted by the availability of production capacity. Secondly, we accelerated the growth in R&D resources and re-organised the R&D function to ensure that appropriate resources are allocated to the development of both our existing bulk piezo technology and our new thin film piezo technology. Given that the industry is still at an early stage of the transition from analogue to digital printing, and the size of the potential opportunity, we are committed to continuing to make substantial R&D investment for many years to ensure that Xaar maximises its future potential.

Our strategy is to drive the development of Xaar technology into selected multiple applications and industries, delivering sustainable profitable growth. Our tactics are to become the primary enabler of change in our target markets, leading the initial wave of conversion, and then to protect our position through replacement product sales enabled by continuous product development. The size of the conversion opportunity, the rate of change, and the key characteristics enabling that change will vary from market to market. OEMs are mostly market specific which means we work with a number of OEM customers in developing their inkjet solutions for a discrete market.

Further detail on our strategy and progress made in 2013 is set out in the 'Our strategy' section.

Market adoption of our technology strengthened during the year with revenues from industrial applications growing 79% and packaging applications growing 31%. Our graphics business grew very modestly and is expected to grow faster following the launch of the Xaar 501 in 2014. Within Industrial applications, the ceramic tile business moved ahead very strongly with laminate and advanced/additive manufacturing applications making encouraging but early modest progress.

‘2013 has been an exceptional year for Xaar and represents the fourth year in a row of substantial growth in both revenue and profits.’

Within the packaging applications the primary label revenues grew strongly whilst the coding and marking revenues were stable. Good technical progress was made in the ‘direct-to-shape’ application; material revenues are not expected until 2015 at the earliest.

The doubling of R&D spending and the creation of two discrete R&D labs, each focused on its own technology stream, is intended to enable a multi-year pipeline of new products based on both bulk and thin film piezo technology. During 2014 both the Xaar 1002 and the Xaar 501 products will launch, which are intended to both strengthen our offering in existing markets and open up new opportunities. Also releasing in early 2014 is our gigabit ethernet based electronics sub-system named XPM. This product offers customers significantly increased data transfer rates and memory for data intensive applications.

Additionally, during 2014 we will market test a completely new bulk piezo jetting structure aimed at significantly higher film weight applications where drop sizes up to 10,000 times the size normally used in digital printing are required. If successful, material revenues could be expected from 2015 onwards.

Significant progress has been achieved on our thin film technology development during the year, culminating in a successful internal technology demonstration in December 2013. The first thin film product development is now under way and as previously stated we would anticipate sampling this to customers in 2015 with first commercial revenues planned for late 2016. The thin film programme is aimed at converting new markets and accelerating the conversion of others through a portfolio of new products.

Substantial capacity and capability have been added to the Company during the year including £19.8 million of capital asset additions, 2,500 m^2 of additional laboratory and design/development space, and over 300 people hired. I would like to thank all of our staff for their efforts to achieve this substantial change in scale of the Company over such a short period.

Whilst growth is expected to be more modest over the next period, looking further forward the opportunities for digital print continue to develop, with industry forecasts projecting that the conversion to digital over the next 10 years is expected to be twice that seen in the last 20 years. Technology and product developments are key to this change and Xaar is committed to maximising its opportunity by continuing to push at the forefront of this revolution.

After 12 challenging and enjoyable years at Xaar I have decided to retire during 2015. My decision is entirely a personal one, and I remain fully committed to continuing the development of the Company between now and my planned retirement date. We are beginning the search for my successor now, and I will ensure that a smooth transition occurs during 2015.

Creating sustainable value

Xaar is the world's leading supplier of industrial printheads. The core business is the design, manufacture, marketing and sale of printheads and associated products, and Xaar also receives licensee royalty income from the legacy licensing model.

Xaar designs

Xaar invests a substantial proportion of sales (12% in 2013) in R&D to remain a world leader in inkjet technology.

Xaar's innovative products are used in a range of print applications including wide-format graphics, ceramics, labels, packaging, coding and marking, and decorative laminates.

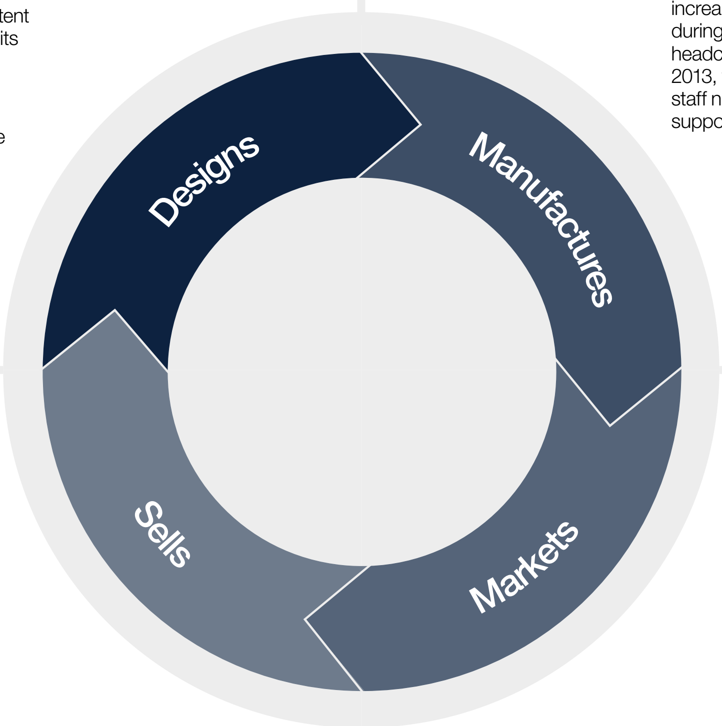
Xaar has around 500 patents and patent applications and continues to add to its Intellectual Property (IP) portfolio.

During 2013 we increased the R&D headcount by 64%. Our HQ is based in the prestigious Cambridge Science Park, Cambridge, UK – which is also where our R&D is located, over three sites.

Xaar manufactures

Xaar manufactures its printheads in Huntingdon, UK and Järfälla, Sweden. The Huntingdon plant produces the Xaar 1001 product range whilst the plant in Sweden produces the popular Xaar 128 printhead for the wide-format graphics market.

In 2013 a programme began to further increase capacity in Huntingdon by 75% during 2013-2014. The Huntingdon plant headcount significantly increased during 2013, with engineering and production staff numbers growing by 57%, to support the demand for our products.



Xaar sells

Xaar sells to OEMs around the world through its regional sales offices and Xaar-approved distributors. Xaar's highly skilled application engineers offer the highest level of technical support to assist OEMs in the successful design, build, commissioning, and ongoing maintenance of printing systems. Europe and Asia are the primary location of OEMs.

Xaar markets

Xaar offers a wide range of industrial inkjet printheads which are designed and produced to meet the customer-driven requirements of a range of manufacturing applications. Primary markets include graphics, labels, packaging, outer case coding, ceramics, and décor.

Our Strategy – to drive the development of Xaar technology into selected multiple applications and industries, delivering sustainable profitable growth.

Risk
The risk management policy and principal risks and uncertainties are discussed on pages 24 and 25.

Read more page 24

Governance
Details of the effective governance of the Company can be found in the Governance section of this annual report.

Read more page 37

Remuneration
The Directors' remuneration report sets out the policies and practices on executive remuneration.

Read more page 44

Key performance indicators
The key performance indicators (KPIs) relating to our strategy are set out on pages 20 and 21.

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Developing new products and new technology

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Building the eco-system

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Converting multiple markets

Read more page 16

Enhancing our capability

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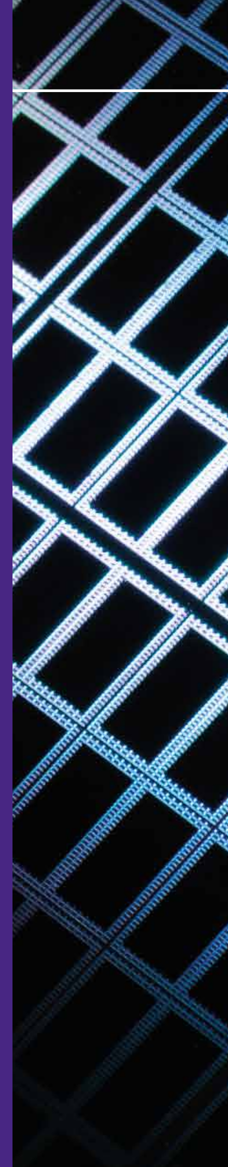
Developing new products and new technology



We manage our product development programmes across three horizons: short term by delivering updates and improvements; medium term by developing new products or derivatives using existing technologies; and longer term through research and development of novel technologies.

Over the short to medium term to create and maintain competitive advantage it is critical that we continue to improve existing products as well as developing new products. Over the medium to long term to access a greater proportion of the enormous industrial print market we must continue to develop new technology which can open up new opportunities for the application of digital inkjet in established analogue markets.

We develop and maintain the different sets of skills and processes needed to successfully execute the programmes in each of the three horizons, and we balance our programme portfolio to achieve short, medium and long term objectives targeted at achieving sustained profitable growth.

Products developed to date use our patented Xaar bulk piezo technology. Our thin film piezo programme is at an early development stage but is on track with the first product launch targeted in late 2016. This technology will enable us to target a wider range of applications.

Inkjet is a heavily patented area and managing our IP is critical to our success, both in terms of protecting our position and avoiding infringing other parties, IP. Our technology is protected by over 500 patents to date.

We allocate significant resources to research and development to enable the successful completion of programmes which will generate future sales.

Progress in 2013

During 2013 we have worked on making our world-leading Xaar 1001 product even better, and this culminated in the launch of the 1002 in early 2014 which delivers even higher print quality and unrivalled reliability. We have also continued to work on development of the Xaar 501 product, which is targeted to build back our position in Graphic Arts. This product will commence sampling to customers during the first half of 2014.

Our new gigabit ethernet based electronic driver sub-system named XPM was also developed during 2013, offering customers significantly increased data transfer rates and memory for data intensive applications. The first units are presently in field trial with commercial shipments expected to commence in H1 2014.

Our thin film programme aims to open up more of the existing analogue market to Xaar through the development of a solution which offers a generational shift in performance. In December 2013 an internal technology demonstration was successfully delivered by the R&D team, and although there is a long way to go on this challenging programme, progress is encouraging and remains on track versus our expectations.

Also during 2013 the base concept design has been completed for a jetting structure capable of firing droplets 10,000 times larger than those normally used in the imaging/decoration process. This structure will be market tested during 2014 in applications requiring significantly higher drop weights and film thicknesses than standard.

In 2013 we increased our investment in R&D by 105% versus 2012 to £16.4 million, which represented 12% of revenue.

Building the eco-system

To successfully penetrate a market, an eco-system of technical and commercial partnerships must be formed to drive and support market conversion.

Xaar's direct customers are OEMs, who manufacture equipment for patterning, decorating, finishing or printing products in a number of different market sectors. We provide our OEM partners with the know-how and ability to incorporate our innovative range of printheads, systems components, and electronics into their equipment to increase the value and functionality of their own products, and minimise the time required to bring products to market.

In addition to our close engagement with OEMs we also actively partner and co-develop with fluid suppliers, hardware and software integrators, and substrate suppliers to deliver a robust and attractive total solution to the end user. We operate an open ink policy so that our customers can choose the ink supplier that best suits them and their application. In addition, we work in partnership with the world's leading ink manufacturers to develop and approve a wide range of inks which are optimised for our printheads and the end application.

Given the complexity of the final integrated solution, it is typical that our partners' development cycles are measured in years rather than months, with successful solutions then benefiting from long commercial lifecycles. To support these developments we deploy sales and technical support staff globally ensuring a local presence in each of the key geographical regions.

Progress in 2013

We continue to work with the leading OEMs in our target sectors as well as the appropriate fluid suppliers, hardware and software integrators, and substrate suppliers in order to deliver a robust and attractive total solution to the end user.

The selection of Xaar by multiple OEMs for the direct-to-shape programmes is a strong indication of our position as market leader in the development of new applications.

Across all markets and applications Xaar now has approaching 250 active eco-system partners.

Converting multiple markets

The markets and applications that use Xaar's printheads can be diverse but can be grouped to have similar characteristics and general imaging requirements.

Xaar's products are designed to provide benefits across multiple applications. This strategy means we can offer solutions across multiple applications through efficiency in development and implementation. We also continuously enhance product performance which allows our OEMs to take advantage of upgrades with minimal changes at the system level.

The Xaar 1001, with its high resolution greyscale (variable drop size) and TF Technology™ (fluid recirculation), ensures an exceptional quality of print in one single pass of the substrate under the printhead, which maximises productivity and delivers significant quality and cost advantages over traditional analogue methods in ceramics and other industrial applications. Although the Xaar 1001 is the market-leading printhead in the ceramics sector, it is also used for printing primary labels, decorative laminates and packaging.

To date we have focused on three main sectors: Industrial, which covers ceramics, decorative laminates and advanced/additive manufacturing; Packaging, which includes product labelling, direct-to-shape (printing directly onto bottles and containers) and coding and marking (printing bar codes and data); and Graphic Arts, which includes wide-format graphics (typically outdoor advertising, posters and banners), commercial print, and varnishing. The wide-format graphics sector was the first to adopt industrial inkjet and is, therefore, the most mature. The ceramics market has been moving into digital inkjet decoration over the last ten years. However, the pace of change accelerated significantly after the Xaar 1001 was launched in 2007.

Progress in 2013

The market-leading Xaar 1001 has continued to make progress in 2013 through multiple applications. Following the success of the product in European ceramic tile manufacturing from 2010 onwards, the Xaar 1001 has been quickly adopted as the solution of choice for ceramic tile decoration in China, the largest producer and consumer of ceramic tiles with c.45% of the world's volume.

Success in the digital decoration of ceramic tiles has uncovered the potential for digital inkjet to provide benefits in other areas of the ceramic tile manufacturing process, such as glaze, structure, and finishing effects. Whilst some of these areas may be serviced by the Xaar 1001 technology, it is likely that new technology may be required to address the balance of those opportunities.

The Xaar 1001 has also made further progress in packaging applications, with five major OEMs delivering leading edge digital presses to the label market in 2013 and four OEMs demonstrating the potential of direct-to-shape technology solutions for the first time in public.

The first digital inkjet decorative laminate lines were installed during 2013, again based on the Xaar 1001. It is expected that after a successful evaluation phase this technology will gain incremental adoption in this market.

The advanced/additive manufacturing development programmes which use the Xaar 1001 range from semiconductors through solar cells to display screens.

Enhancing our capability

In order to successfully develop new products and new technology, and to sustain or grow sales into multiple end markets, we must constantly develop our capability in terms of our human and other resources, specifically both our R&D and manufacturing capacity and capability, and the structure of our organisation.

The success of our business depends on our people so we recruit only the best. We offer competitive salary and benefits packages as well as share incentive plans and our employees benefit from extensive training and development opportunities. We aim to build long term relationships with all our employees by helping them grow and develop and by making Xaar a great place to work and a great Company to be involved with. The result sees our employees staying with us for longer and developing a key understanding of the business. This makes sense for our people, our customers and our shareholders – we know that employees who are engaged with our business deliver better solutions, leading to increased employee satisfaction and increased sales.

Our state-of-the-art manufacturing facilities are located in Huntingdon, UK (5,000 m^2) and Järfälla, Sweden (7,000 m^2). Manufacturing is cleanroom based with 24/7 demands for complex facilities requirements including climate control, gases and chemicals. The cleanrooms contain islands of processing automation, with custom made or specially modified processing and test equipment. Operation is multi-shift and runs with small processing windows and micron scale tolerances. Production involves multiple non-reworkable processing steps, resulting in a highly sensitive cumulative yield; unit cost and throughput are highly dependent upon yield.

Manufacturing is capital intensive; at 31 December 2013 we had already invested over £40 million in our Huntingdon facility since it opened in 2006, and we will be investing a further £20 million before the end of 2014. Capacity must be planned in advance; increments are on a 12 month lead time.

Progress in 2013

As noted throughout this report our investment in headcount grew strongly in 2013, with headcount up 43% year on year, closing 2013 at just short of 800 employees.

We continue to develop our induction programme and the training and development opportunities on offer to our staff.

Our efforts to provide competitive benefit and reward packages, to communicate regularly with all staff and to issue clear and fair policies have paid dividends in terms of employee engagement and low absence rates.

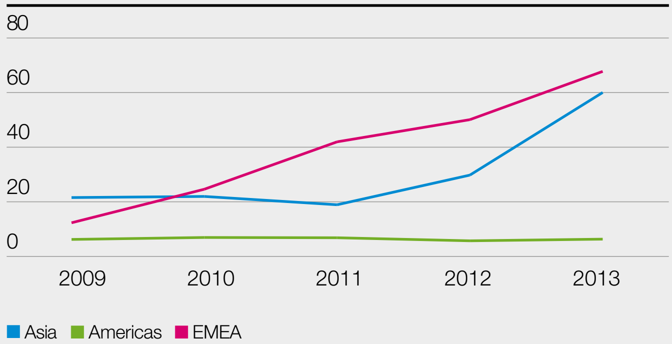
In 2012 we completed an 18 month, £22 million expansion programme in our Huntingdon facility to support the success of our technology in the ceramic tile application. Following the rapid acceleration of the adoption of our technology in China ceramic tile production in quarter four 2012 and early 2013, we began a programme to further increase capacity at the Huntingdon site to ensure that growth over the next few years would not be restricted by the availability of production capability. We are investing around £30 million in total during 2013 and the first half of 2014 to grow capacity c.75% above the level delivered by the expansion programme which completed in 2012.

R&D facility space including both laboratories and design/development space was increased in the year by 2,500 m^2, and Xaar now occupies three buildings on the prestigious Cambridge Science Park.

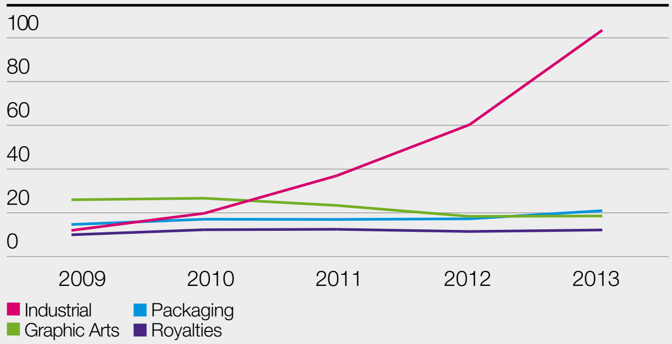
Key performance indicators

Measuring our progress

Adjusted revenue by region
£m

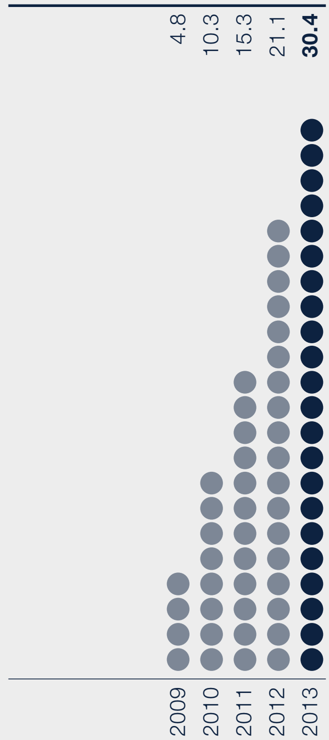


Adjusted revenue by segment
£m



Success in ceramics from 2010 generated a rapid increase in revenues for the Industrial segment. The growth was initially driven by European customers, with OEMs in Asia increasing sales in 2012 and 2013.

Adjusted operating margin
%

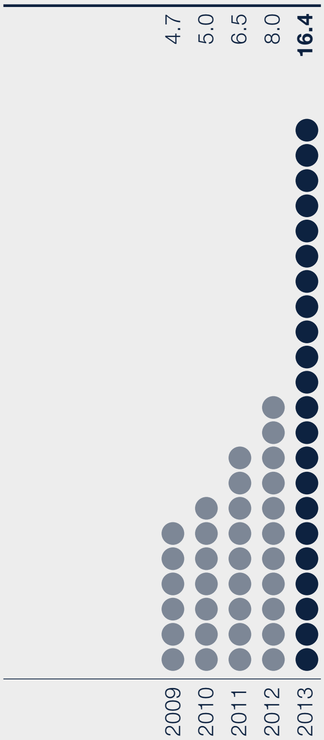


Operating margin has grown as revenues have increased ahead of manufacturing overheads and operating expenditure.

Adjusted profit before tax
£m

Adjusted profit before tax more than doubled in 2013 versus 2012.

R&D investment
£m



The increase in R&D investment has been driven by headcount growth.

R&D investment
% of adjusted revenue

Over 12% of revenues were invested in R&D in 2013.

Net cash balance
£m

Profitability has enabled net cash to grow to over £50 million.

Measures not published:

- Manufacturing costs per unit by product family
- Sales order book
- Production output
- Quality performance
- Health and safety incidents
- Headcount by department

Financial performance in 2013

A year of exceptional growth

Alex Bevis
Finance Director
18 March 2014

Summary of adjusted financials

	2013	2012
Adjusted revenue £m	**£134.1m**	£86.3m
Adjusted gross margin %	**52.9%**	47.4%
Research and development expenses £m	**£16.4m**	£8.0m
Research and development % of adjusted revenue	**12.2%**	9.3%
Adjusted operating profit £m	**£40.7m**	£18.2m
Adjusted operating margin %	**30.4%**	21.1%
Adjusted profit before tax £m	**£41.1m**	£18.4m
Adjusted diluted earnings per share	**43.2p**	20.1p
Net cash balance £m	**£53.5m**	£28.9m
Net cash flow £m	**£24.6m**	£11.5m

Revenue

Adjusted revenue increased by 55% in 2013 to £134.1 million (2012: £86.3 million). The majority of Xaar's revenue is generated by product sales, commissions and fees (£127.2 million or 95% of total sales in 2013), with 5% of revenue in 2013 derived from adjusted licensee royalty income. Revenue reported under International Financial Reporting Standards (IFRS) was £137.1 million in 2013 (2012: £86.3 million). In 2013, £3.0 million of licensee royalty income was recorded which related to the settlement of under-reported licensee royalties for the period 2006 to 2012, and this is excluded in the calculation of adjusted revenue.

Industrial markets (i.e. associated with the production of physical end products) continue to be the largest end application for Xaar's technology. Business in these markets grew by 79% over 2012, generating sales of £98.2 million (2012: £55.0 million), which accounted for 73% of total adjusted revenue (2012: 64%).

The conversion of ceramic tile decoration from analogue to digital processes accelerated in the later stages of 2012 and early part of 2013 through the adoption of Xaar's technology in China, the world's largest market for the production and consumption of ceramic tiles. OEMs in both Europe and China service the Chinese market with Xaar's market-leading 1001 product, which delivers substantial benefits over traditional analogue processes and has now established digital inkjet as the desired standard method of manufacture. Competition in this field has grown from well-established competitors in Xaar's other end markets, including some Xaar licensees, but to date we have been successful in maintaining our dominant market share through the superiority of our technology and products, combined with a competitive pricing strategy. In March 2014 we launched the Xaar 1002, a re-design of the world-beating 1001 product, which provides benefits to OEMs and end users in terms of image quality and ease of use.

Ceramics accounts for well over 90% of sales in the industrial sector, but progress in other industrial applications, including decorative laminates (false wood), continues to be encouraging, with modest growth in year on year sales.

Sales into the packaging market were 31% higher compared with the previous year at £15.7 million (2012: £12.0 million) and represent 12% (2012: 14%) of total sales. The well-established coding and marking application, serviced by Xaar's original product portfolio, continues to provide a steady contribution, with around 50% of sales in the total packaging segment. However, the Xaar 1001 product in primary labels and other packaging applications such as direct-to-shape provided the majority of growth in the sector.

Sales into Xaar's initial end market application, Graphic Arts, delivered 2% growth and totalled £13.3 million for the year (2012: £13.1 million) representing 10% of total sales (2012: 15%). The planned release of the Xaar 501 is due in 2014, and sales from this product are required to build a recovery of sales in this segment closer to the levels seen in earlier years.

As a supplier of technology to OEM partners, our geographic sales split reflects where our products are integrated into the manufacturing equipment, which is not necessarily the end-user location.

In 2013, Europe, Middle East and Africa (EMEA) remained the Company's largest sales region at £67.5 million (2012: £50.0 million), representing 35% growth over the previous year. The primary growth application in Europe was ceramic tile decoration through OEM partners located in Spain and Italy who increasingly addressed the Chinese market, but who also continued to service Europe and made progress in the conversion of manufacturing in South America. Outside of ceramics, primary label and decorative laminate applications continued to grow, albeit on a smaller scale. For 2013 the EMEA region represented 50% of total revenue, compared with 58% in the previous year, although we continue to see European OEMs innovate with digital inkjet technology in a wide range of applications.

During the year, the acceleration of the conversion in the Chinese ceramic tile market was well supported by our Chinese partners as well as our OEMs in Europe. Total adjusted sales in Asia increased by 99% to £59.8 million (2012: £30.0 million) representing 45% (2012: 35%) of total adjusted revenues. In addition to ceramics the Graphic Arts sector continues to be important for sales into Asia.

Total sales to the Americas in 2013 were £6.8 million, an increase of 8% versus the £6.3 million in 2012. As previously stated, we would expect the Americas to remain the smallest geographic region for Xaar due to the distribution of printing equipment manufacturers which tend to be localised in Asia and Europe.

Profitability

Adjusted profit before tax of £41.1 million was achieved for 2013, more than double the £18.4 million recorded for 2012. Profit before tax as reported under IFRS was £40.1 million (2012: £15.7 million). The main reconciling items between the adjusted and IFRS measures are the £3.0 million of royalty income noted earlier and £4.2 million of share scheme related charges recorded under IFRS, but also include exchange differences relating to Swedish operations, unrealised gains/losses on derivative financial instruments, and R&D expenditure credit (per the reconciliation of adjusted financial measures on page 75).

The growth in adjusted profit before tax was ahead of the 55% increase in sales through manufacturing efficiency and operating leverage. Adjusted gross margin increased to 53% (2012: 47%) mainly as a result of the increase in volumes produced in the Huntingdon facility. Manufacturing at Huntingdon was running at 24/7 for the majority of 2013, which is financially efficient but operationally undesirable for long term sustained profitability and risk management. As the capacity expansion programme delivered additional assets during the second half of 2013 margins reduced slightly as depreciation charges increased and this effect is expected to continue as the programme completes during the first half of 2014.

Adjusted operating expenses in 2013 grew 33% versus 2012 to £30.3 million. Expenditure on R&D more than doubled year on year from £8.0 million to £16.4 million, mainly through investment in headcount, facilities and engineering costs. For 2013, following a review of cost allocations, an element of IT, facilities and other business support costs previously entirely charged into general and administrative expenses were allocated to R&D expenses, reflecting the growth of the R&D function in terms of headcount and office and laboratory space. Had a similar re-allocation of costs been applied for 2012 then R&D expenses would have been £9.0 million, with growth in 2013 versus 2012 on this comparative basis of 82%.

Net interest income of £0.4 million was recorded in 2013 (2012: £0.2 million), with interest income on cash and treasury deposits exceeding interest charges on a remaining finance lease.

The tax charge on adjusted profit before tax was £8.0 million (2012: £3.4 million), representing an effective tax rate of 19.5% (2012: 18.6%). This tax charge is the product of the UK and Sweden corporation tax rates (23.25% and 22.0% respectively) reduced by the impact of the patent box scheme and R&D tax credits.

The tax charge on IFRS profit before tax was £8.2 million (2012: £3.1 million) representing an effective tax rate of 20.5% (2012: 19.6%).

Adjusted profit after tax for 2013 (see note 12) was £33.1 million, up 121% from the £15.0 million recorded in 2012.

Adjusted diluted earnings per share increased 115% to 43.2 pence in 2013 (2012: 20.1 pence).

Financial position

The strong financial performance in 2013 drove an increase in net cash (cash and treasury deposits less financing arrangements) of £24.6 million to £53.5 million at 31 December 2013. The increase in net cash is £8.5 million below the £33.1 million figure for adjusted profit after tax, mainly due to capital additions to support the capacity expansion programme. Total cash outflow relating to intangible and tangible assets was £17.0 million in the year, compared with a total amortisation and depreciation charge of £8.3 million. Working capital excluding payables related to capital expenditure and the accrual for NI on potential share option gains, increased by £1.0 million during 2013; inventory grew £2.1 million, receivables increased by £3.0 million, and payables ended the year £4.1 million higher than 2012.

Dividend

The Board will recommend a final dividend of 5.5 pence for 2013 at the forthcoming Annual General Meeting (AGM), giving a total dividend for the year of 8 pence (2012: 4 pence). An interim dividend of 2.5 pence was paid during the year (2012: 1 pence). Subject to approval by shareholders at the AGM the final dividend will be paid on 20 June 2014 to shareholders on the register at close of business on 23 May 2014.

Protecting future value

Effective risk management is key to our success against the characteristics both of the industry that we operate in and within our chosen business model. Our industry, being the world of print, is, in general, declining in terms of total output, tends to be capital intensive, is slow to react to change and is resistant to the adoption of new technology. Product lifecycles tend to be long. Our business model is reliant on us first driving the conversion of well-established processes to our technology, then maintaining our market position to maximise sales through both the initial conversion cycle and replacement sales in order to generate profits to enable us to invest in new technology and open up new applications.

Our risks are set out in more detail in a table on page 25 but the key risk areas can be identified as being associated with the following:

- Opportunity identification – selection and identification, and selection of the appropriate end applications for conversion and defining correctly the market requirements, including time scales
- Development – successfully developing a product with the characteristics that meet the market requirements
- Adoption – working with OEMs and other partners to achieve adoption of the technology in the target application
- Competition – maximising returns over the long term in the target application through early adoption to achieve a market-leading position and then retention of that position
- Operations – having the appropriate manufacturing arrangements and other operational structures in place.

The first approach to managing these risks is to have high quality individuals within the necessary functions that these risks tend to fall into. Other examples of the effective day to day management of these risks include operating multi-functional teams to share knowledge across the business, having regular stage gates in the management of development programmes, and the regular assessment of manufacturing capacity against future potential needs. In addition to day to day processes the Group's risk register is formally reviewed twice per year at senior management and Board level, including the assessment of the performance of risk management during the preceding period.

The Board has applied principle C.2 of the UK Corporate Governance Code by establishing a continuous process for identifying, evaluating, and managing the significant risks the Group faces which has operated throughout the year and up to the date of this report. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance with respect to the preparation of financial information and the safeguarding of assets and against material misstatement or loss.

In compliance with provision C.2.1 of the UK Corporate Governance Code, the Board regularly reviews the effectiveness of the Group's system of internal control. The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management systems. It is based principally on reviewing reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied and indicate a need for more extensive monitoring. The Board has also performed a specific assessment for the purpose of this annual report. This assessment considers all significant aspects of internal control arising during the period covered by the report. The Audit Committee assists the Board in discharging its review responsibilities.

During the course of its review of the risk management and internal control systems, the Board has not identified or been advised of any failings or weaknesses which it has determined to be significant. Therefore a confirmation in respect of necessary actions has not been considered appropriate.

Principal risks and uncertainties

Principal risk and uncertainty	Impact	Mitigation
Product sales into established applications fail to deliver sustained revenue growth due to competitor activity, and associated market share loss, market maturity or other market changes.	Lower than anticipated revenues are achieved resulting in excess production capacity and lower levels of profit.	Competitive pricing policies are employed. The product portfolios and pricing of competitors are constantly monitored. Manufacturing cost reduction programmes are established to ensure that products remain competitive. Close customer relationships are maintained with supply agreements in place where appropriate. New product variants are developed to constantly improve the product portfolio on offer.
Product sales into new applications fail to achieve their targets.	Lower than anticipated revenues are achieved resulting in excess production capacity and lower levels of profit.	Regular reviews of OEM partners are held to ensure that appropriate and extensive market coverage is achieved together with a focus on new equipment manufacture. New products and product variants are developed to meet market requirements. Competitive pricing policies are employed. Manufacturing cost reduction programmes are established to ensure that products remain competitive.
New products fail to achieve their targets through either a failure to identify the appropriate products to meet future market requirements, or the products are identified but are not successfully developed in time or to the required specification.	Longer term revenue and profit is impacted.	Regular, specific and detailed reviews are held to assess current and anticipated market requirements. These reviews include input from customers and other external sources. Product developments are selected on appropriate criteria. Product development activity is properly managed with regular reviews of progress against project plans, and gated milestone reviews. Appropriate resource is applied to product development activity.
Manufacturing output fails to meet demand due to supplier issues, an event at one of the manufacturing facilities, delays or problems associated with production equipment, a lack of manufacturing capacity, or for other reasons.	Demand is not satisfied resulting in lower levels of revenue and profit. Customers may start purchasing (or increase their level of purchasing) with Xaar's competitors, leading to a longer term reduction in market share, revenue and profit.	Detailed sales forecasts are prepared and reviewed regularly to minimise unexpected changes in short term demand. Suppliers are managed carefully. Appropriate sourcing, inspection and inventory holding policies are applied to ensure continuity and consistency of product supply. Appropriate contingency factors are applied to capacity planning. Manufacturing facilities are fitted with the appropriate safety and security systems. Staff are properly trained.
Significant and sustained quality problems are identified with products which have been sold or which are held in inventory.	Lower levels of revenue in the short term whilst the issues are resolved. Unexpected costs associated with resolving the issues, which may include product scrap, warranty costs and/or customer compensation. Potentially longer term revenue loss if customers start purchasing (or increase their level of purchasing) with Xaar's competitors.	Standard operating procedures are in place for all products. Staff are properly trained. The quality of supplies is constantly monitored. Quality performance is regularly reviewed by senior management who apply appropriate resources to systematically address recurrent problems. New products are thoroughly tested before launch. Xaar's Swedish and UK manufacturing facilities are ISO 9001 accredited. Customer returns are reviewed quickly using a consistent and thorough investigation process.

Developing a sustainable business

The Group strongly believes that corporate responsibility is integral to business success. The Group is compliant with all relevant regulation and legislation whilst enhancing the working environment for our employees and minimising the environmental impact of our manufacturing processes. There is internal reporting of key metrics throughout the business, and each member of staff is expected to take individual responsibility for their performance and to work together to achieve shared goals.

Formal directives and certification

The Group manufactures products in both Sweden and the UK and undertakes R&D in the UK. The Group complies with all local and European legislation relevant to the respective territories. The Group's manufacturing facilities in Järfälla and Huntingdon are both ISO 9001 and ISO 14001 certified. It is the Group's policy to maintain this level of certification for its manufacturing facilities and to comply at all times with all relevant environmental and other legislation in the territories in which the Group operates. The Group is compliant with REACH (Registration, Evaluation, Authorisation and restriction of Chemicals), WEEE (Waste Electrical and Electronic Equipment) and RoHS (Restriction of the Use of Certain Hazardous Substances) directives, as required under European legislation.

The Group has a proactive Health and Safety System modelled on OHSAS 18001 in Cambridge, Huntingdon and Sweden.

Social responsibility

- Xaar employees took part in a range of events to raise money for Comic Relief on Red Nose Day in March 2013, and Xaar entered two teams into the BBC Children in Need fun run around the Cambridge Science Park in November 2013.
- A new charitable giving programme was launched by Xaar in 2012, whereby employees could nominate and vote for six charities to each receive a £2,000 donation. The chosen charities for 2013 were Hinchingbrooke Hospital, ABF The Soldiers Charity, The Rosie Hospital Campaign, the British Heart Foundation, the Swedish Childhood Cancer Foundation (Barncancerfonden), and the Swedish Cancer Society (Cancerfonden). In addition to the chosen charity donations, Xaar has sponsored a number of staff and their families engaging in charity events or team activities throughout the year.
- Xaar also made donations to the Oxfam Philippines Typhoon Appeal, Young People of the Year, Comic Relief, Children in Need and the East Anglian Children's Hospice. In total, the Group made charitable contributions to children's, local and national charities during the year totalling £20,204 (2012: £16,806). No political donations were made in the year (2012: £nil).
- The social club, which is aimed at encouraging staff to have fun and get to know each other socially, held several events throughout the year including theatre trips, comedy nights, a punting excursion, sporting events, gliding evenings, Duxford Air Show, ice skating, Cirque du Soleil and nights at the races.
- During 2013 Xaar began sponsorship of an Imagineering Foundation club at a Huntingdon primary school. The Foundation introduces 8-16 year olds to the fascinating world of engineering and technology through fun, hands-on activities. A visit to the Huntingdon factory introduced the pupils to Xaar's manufacturing processes and several engineering staff members explained how different education streams can lead to exciting careers in technology.
- Xaar continues to sponsor PrintIT!. PrintIT! is a major initiative to encourage young people to embark on careers in the UK printing industry.
- In 2013, Xaar invested £1 million in bonds to support the Future Business Centre in Cambridge. The centre provides affordable workspace with support and shared services to new social and environmental enterprises.

Health and safety

It is Xaar's intention to conduct business in a manner that protects the public, the environment, and employee safety. Xaar's Health & Safety policy provides a framework for setting and reviewing of Occupational Health & Safety Objectives. This demonstrates Xaar's commitment to the prevention of injury and ill health and also the continual improvement in Occupational Health & Safety Performance. Xaar recognises that the combination of a safe place of work and safe working practices, together with a productive and innovative environment, are critical to the continued success of the Company.

The management of Xaar is committed to achieving and maintaining full compliance with health and safety legislation. Although certain responsibilities under this policy can be attributed to specific roles within the organisation, and in particular with different levels of management, each and every Xaar employee shares the core basic duty to understand their responsibilities to observe instructions put in place and, where necessary, to draw these to the attention of others.

To achieve its Health & Safety policy, the Company will ensure that the organisation is led by example; systems are in place to engage, train, develop and maintain competent and informed personnel;

resources are allocated to enable safety standards to be maintained; employee involvement and open communication are encouraged; plant, equipment and facilities are safe and without risk to the health and welfare of all persons who could be affected by their use or maintenance; substances required and used in the workplace are handled safely; a comprehensive risk assessment programme is maintained covering all activities and processes, with control measures implemented to minimise risk where applicable; adequate welfare facilities are provided; where accidents or 'near misses' occur, they are reported, investigated and treated as the source of learning for ongoing working practices; and best practice is shared across the Group.

Human rights

The Group respects all human rights and in conducting its business the Group regards those rights relating to non-discrimination, fair treatment and respect for privacy to be the most relevant and to have the greatest potential impact on its key stakeholder groups of customers, employees and suppliers.

The Board has overall responsibility for ensuring that the Group upholds and promotes respect for human rights. The Group seeks to anticipate, prevent and mitigate any potential negative human rights impacts as well as enhance positive impacts through its policies and procedures and, in particular, through its policies regarding employment, equality and diversity, treating customers fairly and information security. Group policies seek both to ensure that employees comply with the relevant legislation and regulations in place in the UK and other operating locations and to promote good practice. The Group's policies are formulated and kept up to date by the relevant business area, authorised by the Board and communicated to all employees.

The Group undertakes extensive monitoring of the implementation of all of its policies and has not been made aware of any incident in which the organisation's activities have resulted in an abuse of human rights.

Equality and diversity

The Group is committed to providing a working environment in which employees feel valued and respected and are able to contribute to the success of the business. Employees are requested to co-operate with the Group's efforts to ensure that the policy is fully implemented.

Based on the closing headcount at 31 December the split of staff by gender was as follows:

	31 December 2013 male/female	31 December 2012 male/female
All employees	**625/170**	445/111
Directors	**8/0**	8/0
Senior Managers	**59/14**	53/11
Employees excluding Directors and Senior Managers	**558/156**	384/100

The Group's aim is that its employees should be able to work in an environment free from discrimination, harassment and bullying, and that employees, job applicants, customers, retailers, business introducers and suppliers should be treated fairly regardless of:

- race, colour, nationality (including citizenship), ethnic or national origins
- gender, sexual orientation, marital or family status
- religious or political beliefs or affiliations
- disability, impairment or age
- real or suspected infection with HIV/AIDS
- membership of a trade union

and that they should not be disadvantaged by unjust or unfair conditions or requirements.

The Group aims to ensure that applications for employment from people with disabilities, and other under-represented groups, are given full and fair consideration and that such people are given the same training, development and job opportunities as other employees. Every effort is also made to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their re-entry into the workplace.

Human Resources policies are reviewed regularly to ensure that they are non-discriminatory and promote equality of opportunity. In particular, recruitment, selection, promotion, training and development policies and practices are monitored to ensure that all employees have the opportunity to train and develop according to their abilities.

The Group places considerable value on the involvement of its employees and has continued to keep them informed of the various factors affecting the performance of the Group. This is achieved through formal and informal meetings. All employees participate in a bonus scheme based on individual performance and Group business targets and, in the UK, have the opportunity to participate in an HMRC approved Share Save Scheme and Share Incentive Plan.

Environmental

The Group has manufacturing sites in Huntingdon, UK and Järfälla, Sweden, R&D and head office functions in Cambridge, UK, and sales offices worldwide. The Group is committed to minimising its impact on the environment through the reduction of waste and by operating its facilities as efficiently as possible. Production material scrap, waste levels and energy usage are all monitored regularly. Our printhead technology improves process efficiency and reduces wastage in our end markets.

Greenhouse gas emissions statement

Xaar plc calculated its global greenhouse gas (GHG) emissions statement using an operational control consolidation approach as described in the Greenhouse Gas: Protocol: A Corporate Accounting and Reporting Standard (Revised Edition, 2004), which reflects the Defra Environmental Reporting Guidelines (Revised October 2013).

Scope 1 emissions occur from sources that are owned or where Xaar plc has operational control. This includes direct emissions from gas combustion in our buildings and fuel used in leased company vehicles. Actual and estimated gas consumption data has been collected from each of the leased properties under the control of the Xaar Group, from data sources including direct meter readings, meter readings from suppliers included on invoices and estimations where required based on available information from property management suppliers and other sources. Actual and estimated mileage data has been collected from the leased company vehicle fleet.

Scope 2 refers to indirect emissions from the consumption of purchased electricity (also including any purchased heat, steam or cooling) from facilities owned or under the operational control of Xaar plc. Actual and estimated data has been collected from each of the leased properties under the control of the Xaar Group, from data sources including direct meter readings, meter readings from suppliers included on invoices and estimations where required based on available information from property management suppliers and other sources.

Assessment parameters

Baseline year	1 January 2013 to 31 December 2013
Consolidation approach	Operational control
Boundary summary	All entities and all facilities under operational control included subject to the materiality threshold applied
Consistency with the financial statements	The only variation is that leased properties deemed to be under operational control have been included in scope 1 and 2 emissions
Materiality threshold	Materiality has been set at Group level at 5%*
Assessment methodology	Greenhouse Gas Protocol and ISO 14064-1 (2006)
Intensity ratio	Emissions per £m turnover excluding royalties

* The total of any excluded emission sources are estimated to be less than 5% of Xaar plc's total reported emissions.

	2013	
GHG emission source	(tCO_2e)	(tCO_2e/£m)
Scope 1	97	1
Scope 2	5,882	46
Statutory total (scope 1 and 2)	5,979	47

The GHG emissions statement includes emissions data from leased assets that are not included in the rest of the consolidated financial statements, other than in note 31 Operating lease arrangements.

Board approval of the strategic and annual reports

The strategic report, annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

Phil Lawler
Chairman

Ian Dinwoodie
Chief Executive

Alex Bevis
Finance Director and Company Secretary

Ramon Borrell
Research and Development Director

Ted Wiggans
Operations and Quality Director

Richard Barham
Sales and Marketing Director

David Cheesman
Non-Executive Director

Robin Williams
Senior Independent Director

Dedicated board with a clear vision

1. Phil Lawler
Chairman
Age 65

Phil has extensive experience of high technology industries. He started with co-founding a software business and subsequently spent 18 years until 2002 at Hewlett Packard in various senior positions, most recently as Chairman and Managing Director of Hewlett Packard, UK and Ireland. Since leaving Hewlett Packard, he has been Chairman of both public companies as well as a number of technology companies, backed by private equity and venture capital investors. He is a Chartered Director.

2. Ian Dinwoodie
Chief Executive
Age 53

Ian joined Xaar in September 2001 as Group Operations Director and was appointed Chief Executive in July 2003. With over 30 years' experience in high technology industries, he has held a variety of roles in engineering, quality assurance and operations within the semiconductor, electronics and electronic imaging sectors. Previous companies include Ferranti Electronics, Digital Equipment Corporation, and Crosfield Electronics. Immediately prior to joining Xaar, he held the position of director of manufacturing for Fujifilm Electronic Imaging Ltd.

3. Alex Bevis
Finance Director and Company Secretary
Age 38

Alex joined Xaar in February 2011 after ten years at CSR plc (Cambridge Silicon Radio). He held a variety of key finance roles at CSR, supporting the growth of the business including the IPO in 2004 and multiple acquisitions. He was most recently employed as Vice President of Finance. He qualified as a Chartered Accountant with Deloitte prior to joining CSR in 2000.

4. Ramon Borrell
Research and Development Director
Age 50

Ramon joined Xaar in August 2007. He had previously been Programme Manager and technology Strategy Director in the large format printing division of Hewlett Packard, where he spent 13 years in Barcelona, Spain, all of them in R&D. He was trained as an industrial engineer and has a Master's degree in Mechanical Engineering, a Master's in Automotive Business and Technology, and an Executive Certificate from MIT-Sloan. Ramon was Vice President and Secretary of the Board of Directors of the Imaging Science and Technology Society from 2005 to 2010.

5. Ted Wiggans
Operations and Quality Director
Age 58

Ted joined Xaar in January 2011, with over 30 years' experience in high technology operations. Immediately prior to joining Xaar he was Chief Operating Officer at Cambridge Semiconductor Ltd (CamSemi). Before joining CamSemi in 2006, he was Operations Director at Zetex Semiconductors with overall responsibility for its multi-site, multi-national manufacturing activities and a global team of 500. In addition, he has held senior-level manufacturing, engineering and quality roles with Motorola and Philips. He is a Chartered Engineer and a member of the Manufacturing Industries Division Board of the IMechE.

6. Richard Barham
Sales and Marketing Director
Age 52

Richard joined Xaar in March 2012, and was previously Vice President of Inkjet at Agfa Graphics N.V. He brings over 25 years of international sales and marketing expertise across many sectors of the imaging and printing industries and has held senior management positions at Agfa, including VP Research & Development, VP Global Marketing and Product Development and VP Commercial Printing.

7. David Cheesman
Non-Executive Director
Age 70

David joined Xaar in July 2011. He obtained an electrical engineering degree from City University before qualifying as a Chartered Engineer with UKAEA. He was a senior engineer with Honeywell, Chief Engineer at CASE Ltd, Technical Operations Director at Univac, Vice President International with Prime Computer Inc. and CEO of Dowty Information Systems Ltd. He then joined the venture capital industry in 1989 and was head of the High Technology Investment Unit at 3i, a Partner in TriTech Investments, and then spent 12 years as a General Partner with Advent Ventures. He has held many directorships on investee companies in the electronics, telecommunications and advanced materials sectors. He was recently a Non-Executive Director of LSI Lasers Ltd, Celoxica plc, Inca Digital Ltd, and K2 Optronics Inc.

8. Robin Williams
Senior Independent Director
Age 56

Robin joined Xaar in March 2010. He obtained an Engineering degree from Oxford before qualifying as a Chartered Accountant with Peat Marwick Mitchell. He spent ten years as a corporate advisor before co-founding Britton Group plc in 1992. As CEO of Britton, he grew the business to £250 million revenues within six years, before selling to a competitor. He was then an Executive Director of Hepworth plc, with a leading role in the rationalisation and subsequent sale of the group. He has subsequently held various public and private company directorships across a range of industries including business services, healthcare, outsourcing, contracting, and manufacturing. Robin is currently Chairman of NHS Professionals Ltd, and a Non-Executive Director of AH Worth & Company Ltd, and Baronsmead VCT 4 plc.

Report on the affairs of the Group

The Directors present their annual report on the affairs of the Group together with the financial statements and auditor's report for the year ended 31 December 2013. The corporate governance statement set out on pages 37 to 68 forms part of this report.

An indication of likely future developments in the business of the Company and details of research and development activities are included in the strategic report. The Group's policies relating to equality, diversity and employee consultation can be found in the 'Corporate social responsibility' section of the strategic report on page 26.

The Greenhouse gas emissions statement can be found on page 28.

Capital structure

Details of the issued share capital, together with details of the movements in the Company's issued share capital during the year, are shown in note 25. The Company has one class of ordinary shares which carries no right to fixed income. Each share carries the right to one vote at general meetings of the Company.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of employee share schemes are set out in note 32.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles of Association, the UK Corporate Governance Code, the Companies Act and related legislation. The Articles themselves may be amended by Special Resolution of the shareholders. The powers of Directors are described in the Main Board terms of reference, copies of which are available on request, and the Corporate Governance Statement on page 42.

Treasury

The Group's policy enables it to use financial instruments to hedge foreign currency exposures. The main trading currency of the Group is UK pounds. The Group's use of financial instruments and the related risks are discussed further in notes 19, 20 and 23.

At the 2013 AGM held on 16 May 2013, the Company's shareholders granted the Company authority to make one or more market purchases (within the meaning of section 693(4) of the Companies Act 2006) of ordinary shares of 10p each in the capital of the Company.

The Company did not purchase any shares for cancellation or to be held as treasury in 2013 or 2012.

Directors and their interests

The Directors who served throughout the year, and subsequent to the year end, were as follows:

Ian Dinwoodie – Chief Executive

Alex Bevis – Finance Director and Company Secretary

Richard Barham – Sales and Marketing Director

Ramon Borrell – Research and Development Director

Ted Wiggans – Operations and Quality Director

Phil Lawler – Chairman

Robin Williams – Senior Independent Director

David Cheesman – Non-Executive Director

Edmund Creutzmann – Chief Technical Officer (to be appointed 1 April 2014)

Brief biographical descriptions of the Directors are set out on page 31. Full details of their interests in shares of the Company and its subsidiary undertakings are included in the Directors' remuneration report on pages 44 to 67.

The interests of the Directors in the shares of the Company and its subsidiaries (all of which are beneficial) as at 31 December 2013 are as follows:

Shareholdings in the Company

	Number of ordinary shares of 10p each 31 December 2013	Number of ordinary shares of 10p each 31 December 2012
Ian Dinwoodie	**57,449**	207,449
Alex Bevis	**41,661**	32,737
Richard Barham	**6,634**	6,000
Ramon Borrell	**178,851**	168,717
Ted Wiggans	**4,634**	2,000
Phil Lawler	**101,430**	101,430
Robin Williams	**–**	–
David Cheesman	**–**	–

There have been no changes in the Directors' interests in shares of the Company between 31 December 2013 and 17 March 2014. Directors' interests in options over shares in the Company are shown in the Directors' remuneration report.

Directors' liabilities

The Company has granted an indemnity to all of its Directors against liability in respect of any potential proceedings that may be brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving the Directors' report.

Share capital

As at 31 December 2013 the Company had been notified in accordance with Chapter 5 of the Financial Conduct Authority's (FCA's) Disclosure and Transparency Rules of the following material interests in its share capital:

	Number of ordinary shares held	Percentage of issued share capital
Schroder Investment Management	**16,720,108**	22.0%
BlackRock	**9,175,746**	12.1%
AXA Framlington Investment Managers	**8,009,823**	10.6%
Legal & General Investment Management	**5,185,285**	6.8%
Standard Life Investments	**3,510,365**	4.6%
Baillie Gifford	**2,564,746**	3.4%
Aviva Investors	**2,316,747**	3.1%

On 7 February 2014, the Company received a notification from BlackRock, Inc. pursuant to the FCA's Disclosure and Transparency Rules, advising that their interests in the total voting rights of the Company were 8,177,650 ordinary shares, being 10.78% of the issued share capital (excluding treasury shares) at the date of the notification.

Report on the affairs of the Group continued

Annual General Meeting

The notice convening the AGM is set out on pages 114 to 116. Resolutions 1 to 14 set out in the notice of the meeting deal with the ordinary business to be transacted at the meeting. The special business at the meeting to be transacted at the meeting is set out in Resolutions 15-17.

Re-election of Directors

Resolutions 5-12

The Company's Articles of Association require the Directors to retire by rotation at least once every three years, with the number to retire by rotation at each AGM being the number nearest to but not exceeding one-third of the Board. However, the UK Corporate Governance Code provides that all directors of FTSE 350 companies should be subject to re-election by their shareholders every year. In accordance with this provision of the UK Corporate Governance Code and in keeping with the Board's aim of following best corporate governance practice, the Board has decided that all Directors should retire at each AGM.

Directors' remuneration report

Resolutions 13 and 14

These Resolutions seek shareholder approval for the Directors' remuneration report, which includes the Directors' remuneration policy. The Directors' remuneration report can be found on pages 44 to 67 (inclusive) of the annual report and accounts.

New regulations came into force on 1 October 2013 in this area, which require the Company to offer shareholders: (i) an annual advisory vote on the implementation of the Company's existing remuneration policy, which is set out in the Directors' remuneration report; and (ii) a binding vote on the Company's forward-looking Directors' remuneration policy, at least every three years.

Resolution 13 contains the advisory resolution relating to the Directors' remuneration report, and Resolution 14 contains the binding resolution in relation to the Directors' remuneration policy.

The Directors' remuneration policy sets out the Company's future policy on Directors' remuneration. If Resolution 14 is approved, the effective date of the remuneration policy will be the date of the AGM.

Authority to purchase own shares

Resolution 15

It is proposed by Resolution 15, by Special Resolution, to authorise the Company generally and unconditionally to purchase its own shares at a price of not less than the par value of the shares and not more than the higher of: (i) 5% above the average of the middle market quotations of the shares as derived from the London Stock Exchange Daily Official List for the five dealing days immediately preceding the day on which the purchase is made; and (ii) the amount stipulated by article 5(1) of the Buy-back and Stabilisation Regulation 2003 (in each case exclusive of any expenses payable by the Company).

The authority will be for a maximum of 14.9% of the Company's issued share capital and will expire at the earlier of the next AGM of the Company or within 15 months from the date of the passing of this resolution. The Directors currently have no intention to exercise the authority and will only purchase shares if it is in the best interests of shareholders as a whole.

The total number of options to subscribe for ordinary shares outstanding at 31 December 2013 (including options awarded under the Long Term Incentive Plan (LTIP) which may be satisfied by the subscription of new shares) was 3,237,052. This represents 4% of the issued ordinary share capital at that date. If Xaar plc was to buy back the maximum number of ordinary shares permitted pursuant to the passing of this resolution, then the total number of options to subscribe for ordinary shares outstanding at 31 December 2013 would represent 5% of the reduced issued ordinary share capital.

Power to issue securities

Resolution 16

Under the Companies Act 2006 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. In accordance with institutional guidelines, under Resolution 16, to be proposed as an Ordinary Resolution, authority is sought to allot shares:

(i) in relation to a pre-emptive rights issue only, up to an aggregate nominal amount of £5,073,117.73, which represented two-thirds of the Company's ordinary share capital as at 18 March 2014, and
(ii) in any other case, up to an aggregate nominal amount of £2,536,558.87, which represented one third of the Company's ordinary share capital as at 18 March 2014.

The Directors do not currently have an intention to exercise the authority.

Resolution 17

This resolution, to be proposed as a Special Resolution, will give the Directors power to allot shares:

(i) up to an aggregate nominal amount of £5,073,117.73 (representing approximately 66% of the Company's issued share capital) on an offer to existing shareholders on a pre-emptive basis (subject to any adjustments, such as for fractional entitlements and overseas shareholders, as the Directors see fit), and
(ii) for cash up to a maximum aggregate nominal value of £380,483.83, representing 5% of the ordinary share capital of the Company as at 18 March 2014, otherwise than in connection with an offer to existing shareholders.

The Directors do not currently have an intention to exercise any power given to them by shareholders to allot shares for cash on a non pre-emptive basis and, in any event, the Directors do not intend to allot any shares for cash on a non pre-emptive basis if such allotment would exceed the limits established by the guidance published by the investment committees of the ABI and the NAPF.

The authorities contained in Resolutions 16 and 17 will expire no later than 15 months after the passing of those resolutions.

Additional information for shareholders

The following provides the additional information required for shareholders as a result of the implementation of the Takeovers Directive into UK law.

The structure of the Company's issued share capital is shown in note 25.

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

The Directors are authorised to issue and allot shares and to undertake purchases of the Company's shares. Appropriate resolutions to renew these authorities are proposed to be passed at the AGM as detailed above and notice of which is on pages 114 to 116.

Ordinary shares

On a show of hands at a general meeting of the Company every holder of ordinary shares present in person and entitled to vote shall have one vote for every ordinary share held and, on a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. The notice of the AGM on pages 114 to 116 specifies deadlines for exercising voting rights either by proxy notice or present in person or by proxy in relation to resolutions to be passed at the AGM. All proxy votes are counted and the numbers for, against or withheld in relation to each resolution are made available at the AGM and are published on the Company's website after the meeting. No person holds securities carrying special rights with regard to control of the Company.

Restrictions

There are no restrictions on the transfer of ordinary shares in the Company other than:

- certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws and market requirements relating to close periods), and
- pursuant to the Listing Rules of the FCA whereby all employees of the Company require the approval of the Company to deal in the Company's securities.

The Company's Articles of Association may only be amended by a Special Resolution at a general meeting of the shareholders. Directors are reappointed by Ordinary Resolution at a general meeting of the shareholders.

Appointment of Directors

The Board can appoint a Director but anyone so appointed must be elected by an Ordinary Resolution at the next general meeting. All Directors are required to submit themselves for reappointment every year at the AGM.

Significant interests

Directors' interests in the share capital of the Company are shown in the table on page 33. Major interests (i.e. those greater than 3%) of which the Company has been notified are shown on page 33.

Company share schemes

The Xaar plc ESOP Trust holds 1.9% of the issued share capital of the Company in trust for the benefit of employees of the Group and their dependants. The voting rights in relation to these shares are exercised by the Trustees.

Change of control

The Company is not party to any agreements which take effect, alter or terminate upon a change of control of the Company following a takeover bid. There are no agreements between the Company and its Directors or employees providing for compensation for loss of office or employment (whether through resignation, purported redundancy or otherwise) that occurs because of a takeover bid. Depending on the achievement of performance conditions, share-based payment arrangements may vest on change of control but this is subject to the approval and exercise of the discretion of the Remuneration Committee.

Report on the affairs of the Group continued

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the strategic report on pages 8 to 19. Notes 19, 20 and 23 include a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Group has considerable financial resources and through a diverse customer base is exposed not only to the Western economies but also China, India and Latin America. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully.

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future, based on the Group's forecasts and projections for the next four years, taking account of reasonably possible changes in trading performance. For this reason, we continue to adopt the going concern basis in preparing the financial statements.

Auditor

Deloitte LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming AGM.

Directors' statement as to disclosure of information to auditor

The Directors who were members of the Board at the time of approving the Directors' report are listed on page 32.

Having made enquiries of fellow Directors, each of these Directors confirm that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditor is unaware, and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Corporate governance statement

The Company is committed to the principles of corporate governance contained in the UK Corporate Governance Code which was issued in 2010 by the Financial Reporting Council ('the Code') for which the Board is accountable to shareholders.

Statement of compliance with the Code

Throughout the year ended 31 December 2013 the Company has been in compliance with the provisions set out in the Code.

The Board confirms that the 2013 annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the performance, strategy, and business model of the Company, in accordance with C.1.1 of the Code.

Statement about applying the principles of the Code

The Company has applied the principles of the Code, including both the Main Principles and the supporting principles, by complying with the Code as reported above. Further explanation of how the Main Principles have been applied is set out below and, in connection with Directors' remuneration, in the Directors' remuneration report.

Board of Directors

The Board of Directors comprises the Chairman, five Executive Directors and two Non-Executive Directors. Brief biographical details of all members of the Board are set out on page 31.

The Board considers Robin Williams and David Cheesman to be independent within the meaning of the Code, in compliance with Code provision B.1.1. To be considered as independent each Non-Executive Director is sufficiently separate to management and free from any business or other relationships which could affect their judgement, impartiality or objectivity.

The Board is responsible for the formulation of strategy; the monitoring of financial and non-financial performance and the approval of major transactions; financial statements; other formal communications with shareholders; and operating and capital expenditure budgets. Comprehensive Board papers, dealing with all aspects of the business, are distributed by the Company Secretary typically one week in advance of each Board meeting. The Board met ten times during 2013.

The Non-Executive Directors attend the Board meetings, and form the Audit, Remuneration and Nomination Committees. They are responsible for scrutinising the performance of management and determining appropriate levels of remuneration of Executive Directors, and have a key role in appointing and, where required, removing Executive Directors.

There exists a clear division of responsibilities between the Chairman and the Chief Executive. The Chairman's primary role includes ensuring that the Board functions properly, that it meets its obligations and responsibilities, and that its organisation and mechanisms are in place and are working effectively. The Chief Executive's primary role is to provide overall leadership and vision in developing, with the Board, the strategic direction of the Company. Additionally, the Chief Executive is responsible for the management of the overall business to ensure that strategic and business plans are effectively implemented, the results are monitored and reported to the Board, and financial and operational objectives are attained.

The Board delegates management of the business to the Executive Committee, headed by the Chief Executive (Ian Dinwoodie). The Executive Committee meets weekly and is responsible for implementing Group strategy, monitoring business performance, preparing the operating and capital expenditure budgets for recommendation to the Board, and ensuring efficient management of the Group.

The committee has formally identified Ted Wiggans as Director responsible for health and safety and Alex Bevis as Director responsible for risk assessment.

Corporate governance statement continued

Summary of Board meeting attendance in 2013

Ten Board meetings were held in 2013.

Name	Meetings attended
Phil Lawler	10 (10)
Robin Williams	10 (10)
David Cheesman	10 (10)
Ian Dinwoodie	10 (10)
Alex Bevis	10 (10)
Richard Barham	9 (10)
Ramon Borrell	10 (10)
Ted Wiggans	10 (10)

Figures in brackets denote the maximum number of meetings that could have been attended.

Board committees

Summary of committee membership:

Name	Audit Committee	Remuneration Committee	Nomination Committee
Phil Lawler	Yes	Yes	Yes
Robin Williams	Chairman	Yes	Yes
David Cheesman	Yes	Chairman	Chairman
Ian Dinwoodie	No	No	Yes

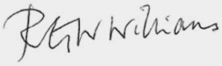
Summary of committee meeting attendance in 2013:

Name	Audit Committee	Remuneration Committee	Nomination Committee
Number of meetings held	**4**	**6**	**4**
Phil Lawler	4 (4)	6 (6)	4 (4)
Robin Williams	4 (4)	6 (6)	4 (4)
David Cheesman	4 (4)	6 (6)	4 (4)
Ian Dinwoodie	N/A	N/A	4 (4)

Figures in brackets denote the maximum number of meetings that could have been attended.

Conflicts of interest

Following the changes made to the Company's Articles of Association to incorporate the provisions of section 175 of the Companies Act 2006 which gave Boards the statutory power to authorise conflicts of interest, any potential conflict of interest is approved by the Board in advance of any action or appointment that could result in a conflict of interest arising. Each member of the Board is familiar with the procedure to follow in relation to conflicts of interest and the process is operated efficiently.



Robin Williams
Chairman of the Audit Committee

Audit Committee

Governance

The Audit Committee is appointed by the Board from the Non-Executive Directors of the Company. The Chairman of the committee, Robin Williams, is deemed by the Board to have recent and relevant financial experience as he is a qualified Chartered Accountant, and has ten years' experience of advising public companies followed by a further ten years as CEO or Executive Director at the centre of substantial public companies either overseeing or working closely with CFOs and Financial Controllers.

The Audit Committee's terms of reference include all matters indicated by Disclosure and Transparency Rule 7.1 and the UK Corporate Governance Code. The written terms of reference of the committee are available on request from the Company Secretary.

Please see the tables on page 38 for details of the Audit Committee members in the year and the number of Audit Committee meetings attended. The committee meetings are also attended, by invitation, by the Group CEO, the Finance Director and other senior financial management as appropriate, as well as by the external auditor for specific parts of the meeting.

Responsibilities

The Audit Committee's primary responsibilities are:

- to monitor the integrity of the financial statements and announcements and review significant financial reporting judgements contained therein, as well as financial and accounting policies and practices
- to keep under review the adequacy and effectiveness of internal controls and risk management systems
- to review procedures, systems and controls for whistle blowing, fraud detection and bribery prevention
- to review, approve and monitor internal audit activities
- to monitor and review the Group's external auditor's independence, objectivity and effectiveness, and
- to make recommendations to the Board on the appointment, remuneration and terms of engagement of the external auditor.

The Audit Committee is not responsible for the identification of key risks and review the adequacy of arrangements to mitigate those risks, which remains the responsibility of the main Board. The Audit Committee is required to report its findings to the Board at least annually, identifying any matters on which it considers that action or improvement is needed, to make recommendations on the steps to be taken, and to ensure that the required actions are taken.

Corporate governance statement continued

Significant issues

The Audit Committee has a set agenda for each of its regular meetings, which is then augmented by specific matters concerning the Company and in assessing the appropriateness of the financial statements. Key areas of focus during the year included:

Legislative and tax changes

The Audit Committee considered the legislative changes that impact the Group 2013 financial statements relating to narrative reporting, including GHG emissions statements and remuneration reports, patent box and R&D expenditure credit. Potential issues in these areas were highlighted and discussed by the Audit Committee. The requirements of each significant change were reviewed, planned and actions agreed and taken, to successfully implement these modifications.

Royalty audits

The results of completed royalty audits in the year were discussed by the Audit Committee, including the required accounting treatments for the financial statements. The actions relating to the outcomes of completed audits and the ongoing royalty audits were agreed.

System audits and the ERP system

Following the implementation of the Epicor ERP system in 2012, KPMG were engaged to perform process reviews and internal audit procedures over a number of specifically targeted areas. The Audit Committee reviewed potential and actual issues encountered, and the results of the completed audits in the year. Planned procedures to be undertaken going forward were proposed and agreed by the Audit Committee.

Significant issues considered

Significant issues that have been considered by the Audit Committee include revenue recognition, inventory valuation, capitalisation of internally generated intangible assets and provisions. These are also areas of focus for the external auditor, who report on these matters to the Audit Committee.

Key activities

As a result of its work during the year, the Audit Committee has concluded that it has acted in accordance with its terms of reference. The Audit Committee terms of reference were updated in 2013, following their annual review. The Chairman of the Audit Committee will be available at the AGM to answer any questions about the work of the committee.

The Audit Committee has performed actions to discharge its responsibilities during 2013, and its effectiveness was reviewed as part of the overall annual Board effectiveness review. The committee has carried out the activities described as follows:

Financial statements and reports

- Reviewed the annual report and financial statements, the half-yearly financial report and as part of this review the Audit Committee received a report from the external auditor on their audit and review performed
- Reviewed legislative changes relating to narrative reporting, including GHG emissions statements and remuneration reports, patent box and R&D expenditure credit
- Reviewed the effectiveness of the Group's internal controls and disclosures made in the annual report and financial statements.

Risk management

- Reviewed fraud detection and the systems and controls for the prevention of bribery
- Assessed improvements planned relating to the identification, assessment and monitoring of risk.

Internal audit

- Agreed a schedule of the internally and externally resourced internal audit activities, and reviewed the results of internal audit activities performed by external resource
- Reviewed the internal financial controls and risk management systems
- Reviewed the compliance and whistle-blowing policies
- Reviewed the results of system processes reviews completed in the year.

External audit

- Reviewed and agreed the scope of the audit work to be undertaken by the auditor, and reviewed non-audit services provided and the level of this compared with the audit services provided
- Agreed the fees to be paid to the external auditor in respect of their services rendered for the annual audit and interim review
- Reviewed audit work performed on significant risk areas, including those areas identified and discussed by the external auditor in their report, and ensured the independence and objectivity of the external auditor and reviewed the audit partner rotation requirement.

External auditor

Deloitte LLP have been the Company's auditor since 2009 and there has been no tender held for audit services during that time. The committee considers that the auditor's knowledge of the Group's business and systems gained through experience has contributed to the effectiveness of the audit process. The committee intends the Company to continue to comply fully with the FRC Audit Committees Guidance regarding the frequency of audit tender. The current audit engagement partner steps down this year under the standard rotation process.

The Audit Committee has noted that there are no contractual obligations to restrict the choice of external auditor and has considered the likelihood of a withdrawal of the auditor from the market.

The committee meets with the Company's auditor at least twice a year. The Chief Executive and Finance Director, and other relevant managers as required, attend by invitation, except for a period of each meeting where the committee members may meet with the auditor without any member of the Group management present.

The committee is required to assess the qualifications, expertise, resources, and independence of the external auditor, and the objectivity and effectiveness of the audit process. The committee reviews the type of work, effectiveness of, and level of fees charged by the auditor on an annual basis and recommends to the Board the appointment, reappointment, term, remuneration, and terms of engagement of the external auditor. Auditor objectivity and independence is safeguarded by the committee monitoring fees paid to the auditor in respect of both audit and non-audit work, and approving all additional work performed by the external auditor. Non-audit services include tax compliance and advice services, and recruitment and remuneration services.

Note 6 to the consolidated financial statements includes disclosures of the auditor's remuneration for the year, including an analysis of audit services, audit related services, and other non-audit services under those headings prescribed by law. The committee monitors the level of non-audit fees in relation to the audit fee for its bearing on external auditor independence.

The independence and objectivity of the auditor is regularly considered by the committee taking into consideration relevant UK professional and regulatory requirements. The committee receives an annual statement from the auditor detailing their independence policies and safeguards and confirming their independence, taking into account relevant ethical guidance regarding the provision of non-audit services by the external auditor. Under the standard rotation process, the current audit engagement partner steps down this year, and a new audit partner has been appointed for 2014.

The committee considers the effectiveness of the external audit and the Group's relationship with the external auditor, Deloitte LLP, on an ongoing basis, and have conducted a review of the effectiveness of the annual audit. This review consisted of considering a number of key points together with the senior financial management of the Group, without the external auditor present, and then discussing the evaluation with the auditor. The committee was able to conclude, on the basis of this exercise and its experience over the year, that the external audit process remained effective. A further review will be carried out following the completion of audit procedures on all Group companies and reported on in next year's annual report.

Corporate governance statement continued

David Cheesman
Chairman of the Remuneration and Nomination Committees

Remuneration Committee

Governance

The Remuneration Committee is appointed by the Board from the Non-Executive Directors of the Company. The Chairman of the committee is David Cheesman. The Chief Executive and Finance Director attend meetings by invitation, except when their own remuneration package is being discussed. The written terms of reference of the committee are available on request from the Company Secretary.

Responsibilities

The Remuneration Committee's primary responsibilities are:

- to make recommendations to the Board on the Group's policy for executive remuneration, and review the ongoing appropriateness and relevance of the policy
- to review the design of all share incentive plans and oversee any major changes in employee benefit structures
- to monitor the level and structure of remuneration for Senior Managers, and
- to determine the individual remuneration packages on behalf of the Board for the Executive Directors of the Group.

Key issues and activities

The committee has access to professional advice, both inside and outside the Company, in the furtherance of its duties. The committee has received information on best practice and market rates for Directors' remuneration from Deloitte LLP and PwC LLP during the year, and guidance on best practice on adopting the new legislation.

The Directors' remuneration report sets out in more detail the committee's policies and practices on executive remuneration.

Nomination Committee

Governance

The Nomination Committee is appointed by the Board from the Non-Executive Directors of the Company and the Chief Executive. The Chairman of the committee is David Cheesman. The committee meets as required. The written terms of reference of the committee are available on request from the Company Secretary.

Responsibilities

The Nomination Committee's primary responsibilities are:

- reviewing the size, structure, skills, knowledge and composition of the Board
- formulating plans for succession for both Executive and Non-Executive Directors, and
- making recommendations to the Board on the appointment of new Executive and Non-Executive Directors and their reappointment following retirement by rotation.

Key issues and activities

The process adopted by the committee to identify a candidate for a specific vacancy is, in the first instance, to determine whether any individuals known to the committee would be suitable for the role. If no candidates can be identified through this process then an external search consultancy will be approached. Shortlisted candidates are interviewed by members of the committee and other Executive and Non-Executive Directors as the committee deems appropriate. Once a suitable candidate has been identified, the Chairman of the committee will recommend to the Board that the Company make a formal offer of employment to the candidate.

All Directors are required to submit themselves for reappointment every year and Directors appointed during the year are required to seek reappointment at the first AGM following their appointment.

Performance evaluation

The Board's policy for individual Executive Director performance reviews is for a formal and rigorous appraisal process based on performance by the individual Director against specific targets. Individual Director performance is reviewed at least annually. The Senior Independent Director, in consultation with the other Non-Executive Directors and taking into account the views of the other Directors, appraises the performance of the Chairman. The Executive Directors, in consultation with the Chairman, appraise the performance of the Non-Executive Directors.

When new Directors are appointed, they receive a complete and specifically bespoke induction and training, aimed at introducing and familiarising them to the management team, the Group's activities and processes, and to give them the knowledge required to effectively execute their role.

The Board reviewed both its own performance and the performance of the Board committees once during the year through a questionnaire issued to all members of the Board. The results were reviewed by the Board as a whole and it was concluded that individual Board members are satisfied that the Board works well and operates effectively in an environment where there is constructive challenge from the Non-Executive Directors. They are also satisfied with the contribution made by their colleagues and that Board committees operate properly and effectively. It is the Board's intention to review its own performance, and that of its committees, at least once a year.

Group structure

The Group has three main locations. The head office functions, R&D, Western sales, marketing function and business support functions are based in Cambridge, UK. The Group also has two manufacturing facilities: one in Järfälla, Sweden and the other in Huntingdon, UK. The Group also has representatives in other global locations including India, Brazil, Hong Kong and the USA.

Refer to page 10 for the Xaar business model.

Dialogue with institutional shareholders

The Directors seek to build on a mutual understanding of objectives between the Group and its institutional shareholders by meeting at least twice per year, following interim and annual results, to provide an update on trading and obtain feedback. Additionally, the Group has hosted institutional investors at its Huntingdon facility during the year.

The Group's financial public relations advisors give all investors and potential investors, who have met with the Group's investor relations team, the opportunity to provide feedback on the meetings. The feedback is coordinated by the financial PR advisors into a single document which is circulated to all members of the Board. Additionally, the Chief Executive and Finance Director provide feedback to the Board at the meeting following shareholder meetings to ensure that the Board, and in particular the Non-Executive Directors, possess an understanding of the views of the Company's major shareholders. Both the Chairman and the Senior Independent Director are available to meet with shareholders as required.

Shareholders can access up-to-date Company information from the Investor Relations section of the Xaar website at www.xaar.com.

Constructive use of the Annual General Meeting

The Board uses the AGM to communicate with investors and to encourage their participation.

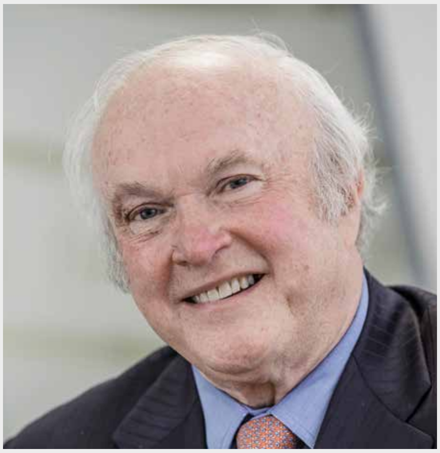
Risk management and internal control

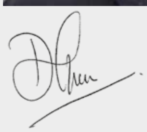
The Group's policies relating to risk management and internal control can be found in the 'Risk management' section of the strategic report on page 24.

Whistle-blowing, and anti-bribery and corruption policies

The Company conducts its business with the highest standards of integrity and honesty at all times and expects its employees to maintain the same standards in everything they do. Employees are therefore required to report any wrongdoing by Xaar or its members of staff that falls short of these principles. The whistle-blowing, and anti-bribery and corruption policies are available and communicated to all employees via the Company intranet, and all employees confirm in writing that they have read and comply with the whistle-blowing and anti-bribery and corruption policies. All reported incidences of actual or suspected bribery or corruption will be promptly and thoroughly investigated and dealt with appropriately. The purpose of the anti-bribery and corruption policy is to protect Xaar and its employees from breaches of anti-bribery and corruption laws. Xaar does not tolerate any employee or third party being involved in any level of bribery or corruption. Xaar is committed to complying with applicable anti-bribery and corruption laws in all countries in which it conducts business.

Directors' remuneration report





David Cheesman
Chairman of the Remuneration Committee

This report has been prepared in accordance with Schedule 8 to the Accounting Regulations under the Companies Act 2006. The report also meets the relevant requirements of the Listing Rules of the Financial Conduct Authority and describes how the Board has applied the Principles relating to Directors' remuneration in the UK Corporate Governance Code.

New regulations have come into effect, which impact the presentation and disclosure of Directors' remuneration; the layout of this report reflects those new regulations. This report is, therefore, presented in two sections: the annual report on remuneration and the Directors' remuneration policy. The annual report on remuneration provides details of the amounts earned in respect of the year ended 31 December 2013 and how the Directors' remuneration policy, which sets out the forward-looking remuneration policy, will be operated for the year commencing 1 January 2014. This is subject to an advisory vote at the 2014 AGM. The Directors' remuneration policy will be subject to a binding vote at the 2014 AGM.

Statement from the Chairman of the Remuneration Committee

Dear Shareholder

On behalf of the Board, I am pleased to present our Directors' remuneration report for 2013, which sets our policy on pay, benefits and incentives for the Directors and the amounts earned by the Directors for the year ended 31 December 2013.

The Remuneration Committee's policy is to attract and retain individuals of the highest calibre by offering remuneration competitive with comparable publicly listed companies, and to drive Company performance by providing arrangements which fairly and responsibly reward individuals for their contribution to the success of the Group. Performance related bonuses and equity-based remuneration represent a substantial proportion of Executive Directors' potential remuneration, which the committee feels aligns the interests of the individuals with those of the shareholders.

Remuneration for 2013

Throughout the year, the Remuneration Committee continued to apply the remuneration policy with a strong alignment to the interests of shareholders.

As described in the business review section of this Annual Report, 2013 was a very successful year for Xaar. Significant growth was sustained across the spectrum of operations, from record financial results to increased headcount and operational facilities. Consequently, 100% of base salary was earned by the Executive Directors for the Company profit performance element of the annual bonus plan, compared with a target rate of 50% of base salary and a maximum of 100% of base salary. The bonus earned is then subject to a multiplier in the range of 0-1.33 which is applied to reflect individual performance, where 1.0 is used for 'on-target' individual performance. Details of the bonus amounts earned by individual directors are outlined within the annual report on remuneration. Furthermore, annualised compounded EPS growth over the three year performance period ended 31 December 2013 was 87% and as a result 100% of the Performance Share awards granted under the LTIP on 11 April 2011 will vest on 11 April 2014.

Base salary increases for Executive Directors were in the range 0%-5% from 1 January 2013 for Alex Bevis, Ted Wiggans, Ramon Borrell and Richard Barham, which was in line with the range of salary increases across the Group. A 12% base salary increase was awarded to Ian Dinwoodie to reflect his performance, experience and contribution to the Group and that his base salary had fallen significantly below market positioning.

Further details regarding base salary increases, bonus payments and the vesting of LTIP awards made to the Executive Directors are set out in the annual report on remuneration.

Key remuneration decisions for 2014

The existing remuneration policy and fundamental structure of the package remains unchanged and the overall quantum of the incentives (as a percentage of base salary) has not changed. However, given the outstanding performance and sustained growth of the business, the Remuneration Committee recognises that there exists a significant shortfall in Executive Director base salaries compared with companies of a similar size and complexity. The Non-Executive Director fees have also been reviewed by the Board during the year. Therefore, we have resolved to:

- move base salaries, over a three year period, towards the lower end of the market range, subject to the sustained and continued performance of both the business and of individual Directors. This phased approach (as opposed to awarding the whole increase in one year) has the benefit that it recognises the challenges of the current executive remuneration environment and allows the Remuneration Committee to reassess the intended increases in 2015 and 2016 and consider whether it remains appropriate at that time
- move the Non-Executive Director fees towards the lower end of the market competitive range over the following three years
- introduce a 1 x salary shareholding guideline for Executive Directors who will have until the later of the fifth anniversary of appointment or fifth anniversary of the introduction of the policy to build this level of shareholding, and
- introduce a malus provision, for future awards under the LTIP, to allow the Remuneration Committee to adjust unvested bonus matching awards and unvested Performance Share awards in the event of material misstatement, material failure of risk management, or serious reputational damage.

The Remuneration Committee has consulted with the Company's major shareholders regarding these changes.

David Cheesman
Chairman of the Remuneration Committee
18 March 2014

Directors' remuneration report continued

Annual report on remuneration

This part of the report sets out the actual payments made by the Company to its Directors with respect to the year ended 31 December 2013.

The Remuneration Committee's policy is to attract and retain individuals of the highest calibre by offering remuneration competitive with comparable publicly listed companies, and to drive Company performance by providing arrangements which fairly and responsibly reward individuals for their contribution to the success of the Group. Performance related bonuses and equity-based remuneration represent a substantial proportion of Executive Directors' potential remuneration.

Single figure table

The aggregate remuneration provided to Directors who have served as Directors in the year ended 31 December 2013 is set out below, along with the aggregate remuneration provided to such Directors for the financial year ended 31 December 2012.

Director	Salary/fees[(a)] £'000	Benefits[(b)] £'000	Bonus[(c)] £'000	Long term incentives[(d)] £'000	Pension[(e)] £'000	Total remuneration £'000
Year ended 31 December 2013						
Executive						
Ian Dinwoodie	232	38	255	829	25	1,379
Alex Bevis	151	20	151	408	15	745
Ted Wiggans	162	20	178	408	16	784
Richard Barham	166	21	166	1	17	371
Ramon Borrell[1]	145	20	123	942	15	1,245
Non-Executive						
Phil Lawler (Chairman)	80	–	–	–	–	80
David Cheesman	35	–	–	–	–	35
Robin Williams	38	–	–	–	–	38
Year ended 31 December 2012						
Executive						
Ian Dinwoodie	207	36	145	239	22	649
Alex Bevis	145	20	113	–	14	292
Ted Wiggans	155	20	121	–	15	311
Richard Barham[3]	132	25	103	–	13	273
Ramon Borrell	145	20	74	152	14	405
Phil Eaves[2]	85	11	42	189	9	336
Non-Executive						
Phil Lawler (Chairman)	80	–	–	–	–	80
David Cheesman	35	–	–	–	–	35
Robin Williams	38	–	–	–	–	38

[1] Ramon Borrell will step down from the Board on 1 April 2014.

[2] Phil Eaves retired from the Board on 31 March 2012, but was employed by the company until 29 June 2012.

[3] Richard Barham joined the Board on 5 March 2012.

The figures in the single figure table on the left are derived from the following:

(a) Salary/fees	The amount of base salary/fees received in the year.
(b) Benefits	This is the taxable value of benefits and the flexible benefits allowance received in the year.
(c) Bonus	The value of the bonus earned in respect of the year, including any part of the bonus invested into bonus investment shares for a period of three years. Performance against the targets which applied for the financial year is provided on page 48.
(d) Long term incentives	The value of performance related incentives vesting in respect of the financial year (including any Matching Share Awards granted under the LTIP) and the value of SAYE options and Matching Shares under the HMRC approved Share Incentive Plan (SIP) granted based on the fair value of the options/ shares at grant. The performance condition for the Performance Share Awards and Matching Share Awards granted under the LTIP on 11 April 2011 was EPS growth against RPI over the three year performance period ending 31 December 2013. For the year ended 31 December 2013, the Company's annualised, compounded EPS growth over the three year performance period commencing 1 January 2011 and ending 31 December 2013 was 87%; therefore 100% of the Performance Share Awards and Matching Share Awards in respect of the year ending 31 December 2013 will vest. The estimated face value of the vested shares is based on a share price of 932p being the average market value of Xaar's shares for the last quarter of year ended 31 December 2013 (267p for comparative calculation in 2012 analysis). For the year ended 31 December 2012 comparative figures, 100% of the Performance Share plan Awards and Matching Share Awards in respect of the performance period commencing 1 January 2010 and ending 31 December 2012 vested. Also included in the long term incentives figure are: SAYE options granted in the year, valued at the accounting value on date of grant. Matching Share Awards granted under the SIP scheme during the year, again valued at the accounting value on date of grant.
(e) Pension	The value of the employer contribution to the defined contribution pension plan (or the value of a salary supplement paid in lieu of a contribution to this pension plan).

Individual elements of remuneration

Base salary and fees

Base salaries for Executive Directors are reviewed by the Remuneration Committee prior to the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels, the Remuneration Committee considers the role, responsibility, and experience of the individual, corporate and individual performance, market conditions, and the range of salary increases awarded across the Group.

Base salary increases for Executive Directors were in the range 0%-5% from 1 January 2013 for Alex Bevis, Ted Wiggans, Ramon Borrell and Richard Barham which was in line with the range of salary increases across the Group. A 12% base salary increase was awarded to Ian Dinwoodie to reflect his performance, experience and contribution to the Group and that his base salary had fallen significantly below market positioning.

The remuneration policy for the Non-Executive Directors is reviewed periodically. The fees for the Non-Executive Directors were not increased during 2013.

Directors' remuneration report continued

Benefits

Benefits principally comprise a company car or car allowance, private medical insurance and basic levels of other insurances (such as critical illness cover). In addition, all UK staff, including Executive Directors, are provided with an allowance of 5% of base salary which they can apply to a range of benefits such as life insurance, critical illness insurance etc.

Pension

The Company operates a self-administered, defined contribution, HMRC approved pension scheme. All current Executive Directors participate in this scheme. In appropriate circumstances, Executive Directors may take a salary supplement instead of contributions into a pension plan. Non-Executive Directors do not receive pension contributions.

Annual bonus

For the year ended 31 December 2013, the annual bonus was based on performance against a Group profit target. The maximum bonus opportunity for achievement of the Group profit targets was 100% of salary and this bonus was then subject to a multiplier of between 0 and 1.33 according to individual performance. The maximum possible bonus entitlement was therefore 133% of base salary and this represents the maximum level of Group profit performance and exceptional performance of the individual and the Group.

Group profit is defined as Group adjusted profit before tax, which for 2013 was £41.1 million.

The Board considers the Group profit target to be a matter that is commercially sensitive and should therefore remain confidential to the Company. The Board believes that disclosure of this commercially sensitive information could negatively impact the Company's competitive position by providing our competitors with insight into our business plans, expectations and, in the case of individual performance, our strategic actions resulting in significant risk to future profitability and shareholder value. However, the Remuneration Committee will review this annually, and may disclose some details on a retrospective basis where it considers it appropriate to do so.

Details of the Executive Directors for 2013 are set out in the table below.

Performance against the above measures was assessed by the Remuneration Committee after the end of 2013.

The annual bonus is delivered in cash. Executive Directors may choose to invest the bonus earned (on a post-tax basis) in bonus investment shares, in return for participation in the bonus matching element of the LTIP (see below for further details). Bonus investment shares are beneficially owned by the individual and are not subject to forfeiture. Additionally the Executive Directors can opt to participate in the SIP (refer to note 32 for details of the scheme).

Executive Director	Achievement against Group profit target (potential range 0% - 100%)	Achievement against individual performance targets (range 0 – 1.33)	Resultant bonus pay-out
Ian Dinwoodie	100%	1.1	110% of salary
Alex Bevis	100%	1.0	100% of salary
Ted Wiggans	100%	1.1	110% of salary
Richard Barham	100%	1.0	100% of salary
Ramon Borrell	100%	0.85	85% of salary

Value earned from long term incentive awards

The LTIP was approved by shareholders in April 2007 and comprises two elements: Matching Share Awards and Performance Share Awards.

- Performance Share Awards: subject to the achievement of performance conditions
- Matching Share Awards: as described above, Executive Directors may choose to invest the bonus earned (on a post-tax basis) in bonus investment shares. Matching Share Awards are granted subject to the achievement of performance conditions on a one for one basis (based on the pre-tax) value of the bonus used to acquired bonus investment shares (subject to an overall maximum of 50% of salary).

Performance Share Awards and Matching Share Awards granted to Executive Directors on 11 April 2011 were based on growth in EPS against RPI as shown below:

Annualised, compounded growth in EPS:	% of LTIP awards vesting
RPI + 4% pa	35% vests
RPI + 10% pa	100% vests

Straight-line vesting applies for performance between these levels.

Performance against targets

EPS performance achieved in three year performance period to 31 December 2013	87%
% of 2011 LTIP award due to vest in April 2014	100%

Long term incentives awarded during the financial year

The table below outlines awards made under the LTIP to Executive Directors in 2013:

		Award basis	Number of shares	Face value of the award £'000	Vesting at threshold	Performance period	Vesting date
2 April 2013	Ian Dinwoodie	Performance Share plan Awards: 100% of base salary	54,588	232	35% of award	1 January 2013 to 31 December 2015	2 April 2016
2 April 2013	Alex Bevis		35,529	151			2 April 2016
2 April 2013	Ted Wiggans		38,118	162			2 April 2016
2 April 2013	Richard Barham		39,059	166			2 April 2016
2 April 2013	Ramon Borrell[1]		34,118	145			2 April 2016
15 May 2013	Alex Bevis	Bonus Matching Share plan Award	15,641	96	35% of award	1 January 2013 to 31 December 2015	15 May 2016
15 May 2013	Ted Wiggans		3,773	23			15 May 2016
15 May 2013	Ramon Borrell[1]		16,904	103			15 May 2016

[1] Ramon Borrell will step down from the Board on 1 April 2014.

The share price used to calculate the face value of the award was £4.25 for the 2 April 2013 award and £6.14 for the 15 May 2013 award, being the mid-market price on the day prior to award date.

The performance conditions for these LTIP awards are the same as those applying to the 2012 LTIP awards and are described in full on page 105.

Directors' remuneration report continued

Shareholding guidelines and total shareholdings of Directors

Although there were no formal shareholding guidelines in place in 2013, the majority of Executive Directors already held significant value in shares. With effect from the date of the AGM, the Remuneration Committee will introduce a shareholding guideline of 1 x salary. Executive Directors will have until the later of the fifth anniversary of appointment or the fifth anniversary of introduction of the policy to build this level of shareholding. The extent to which each Executive Director has met the shareholding guideline is shown in the table below:

					Unvested		
	Shareholding guidelines	Current shareholdings (% of salary)	Type	Owned outright	Subject to performance conditions	Not subject to performance conditions	Total as at 31 December 2013
Executive Directors							
Ian Dinwoodie	100% of salary	57,449 (247%)	Shares	57,449	–	–	57,449
			LTIP options	–	229,727	–	229,727
			SAYE options	–	–	–	–
			Matching SIP	–	–	–	–
Alex Bevis	100% of salary	41,344 (274%)	Shares	41,344	–	–	41,344
			LTIP options	–	201,003	–	201,003
			SAYE options	–	–	4,245	4,245
			Matching SIP	–	–	317	317
Ted Wiggans	100% of salary	4,317 (27%)	Shares	4,317	–	–	4,317
			LTIP options	–	150,030	–	150,030
			SAYE options	–	–	4,245	4,245
			Matching SIP	–	–	317	317
Richard Barham	100% of salary	6,317 (39%)	Shares	6,317	–	–	6,317
			LTIP options	–	105,726	–	105,726
			SAYE options	–	–	–	–
			Matching SIP	–	–	317	317
Ramon Borrell	100% of salary	N/A*	Shares	178,534	–	–	178,534
			LTIP options	–	271,858	–	271,858
			SAYE options	–	–	5,014	5,014
			Matching SIP	–	–	317	317
Non-Executive Directors							
Phil Lawler (Chairman)	–	–	Shares	101,430	–	–	101,430
David Cheesman	–	–	Shares	–	–	–	–
Robin Williams	–	–	Shares	–	–	–	–

* Ramon Borrell will step down from the Board on 1 April 2014.

There have been no changes in the Directors' holdings in the share capital of the Company, as set out in the table above, between 31 December 2013 and 18 March 2014.

Outstanding Directors' share awards

The awards held by Executive Directors of the Company under the LTIP are shown below:

LTIP

The outstanding awards granted to each Executive Director of the Company under the Xaar plc 2007 LTIP are as follows. All options under the LTIP are nil-cost options such that no exercise price is payable. The performance conditions for these LTIP awards are the same as those applying to the 2012 LTIP awards and are described in full in note 32.

Name	As at 1 January 2013	Granted during the year	Exercised during the year	As at 31 December 2013	Grant date	Share price at date of grant	Earliest date of exercise	Expiry date
Ian Dinwoodie	89,573	–	(89,573)	–	22 November 2010	£2.11	22 November 2013	22 November 2020
	88,889	–	–	88,889	11 April 2011	£2.29	11 April 2014	11 April 2021
	86,250	–	–	86,250	2 April 2012	£2.36	2 April 2015	2 April 2022
	–	54,588	–	54,588	2 April 2013	£4.20	2 April 2016	2 April 2023
	264,712	54,588	(89,573)	229,727				
Alex Bevis	43,556	–	–	43,556	11 April 2011	£2.29	11 April 2014	11 April 2021
	60,417	–	–	60,417	2 April 2012	£2.36	2 April 2015	2 April 2022
	45,860	–	–	45,860*	1 May 2012	£2.28	1 May 2015	1 May 2022
	–	35,529	–	35,529	2 April 2013	£4.20	2 April 2016	2 April 2023
	–	15,641	–	15,641*	15 May 2013	£6.14	15 May 2016	15 May 2023
	149,833	51,170	–	201,003				
Ted Wiggans	43,556	–	–	43,556	11 April 2011	£2.29	11 April 2014	11 April 2021
	64,583	–	–	64,583	2 April 2012	£2.36	2 April 2015	2 April 2022
	–	38,118	–	38,118	2 April 2013	£4.20	2 April 2016	2 April 2023
	–	3,773	–	3,773*	15 May 2013	£6.14	15 May 2016	15 May 2023
	108,139	41,891	–	150,030				
Richard Barham	66,667	–	–	66,667	2 April 2012	£2.36	2 April 2015	2 April 2022
	–	39,059	–	39,059	2 April 2013	£4.20	2 April 2016	2 April 2023
	66,667	39,059	–	105,726				
Ramon Borrell	205,357	–	(205,357)	–	1 April 2009	£0.56	1 April 2012	1 April 2019
	56,872	–	(56,872)	–	22 November 2010	£2.11	22 November 2013	22 November 2020
	60,844	–	–	60,844	11 April 2011	£2.29	11 April 2014	11 April 2021
	40,000	–	–	40,000*	3 May 2011	£2.42	3 May 2014	3 May 2021
	60,417	–	–	60,417	2 April 2012	£2.36	2 April 2015	2 April 2022
	59,575	–	–	59,575*	1 May 2012	£2.28	1 May 2015	1 May 2022
	–	34,118	–	34,118	2 April 2013	£4.20	2 April 2016	2 April 2023
	–	16,904	–	16,904*	15 May 2013	£6.14	15 May 2016	15 May 2023
	483,065	51,022	(262,229)	271,858				

* LTIPs granted as part of the bonus matching scheme.

Directors' remuneration report continued

All employee share plans

The Executive Directors may participate in the Company's all employee share plans, the Xaar plc 2007 SAYE Scheme (SAYE Scheme) and the Xaar SIP, on the same basis as other employees.

The SAYE Scheme provides an opportunity to save a set monthly amount (currently up to £250) over three years towards the exercise of a discounted share option, which is granted at the start of the three years.

The SIP provides an opportunity for employees to buy shares from their pre-tax remuneration up to the limit permitted by the relevant tax legislation (currently £1,500 per year) and are awarded additional shares for free on a matching basis; the Company currently operates the plan on the basis of a 1:1 match but may award Matching Shares up to the maximum ratio permitted by the relevant tax legislation (currently a 2:1 ratio).

Options and awards under these plans are not subject to performance conditions.

The outstanding awards granted to each Executive Director under the SAYE Scheme are as follows:

Name	As at 1 January 2013	Granted during the year	Exercised during the year	As at 31 December 2013	Grant date	Exercise price	Earliest date of exercise	Expiry date
Alex Bevis	4,245	–	–	4,245	1 November 2011	£2.12	1 November 2014	1 May 2015
Ted Wiggans	4,245	–	–	4,245	1 November 2011	£2.12	1 November 2014	1 May 2015
Ramon Borrell	2,524	–	–	2,524	21 December 2010	£1.74	1 February 2014	1 August 2014
	2,490	–	–	2,490	1 November 2012	£1.85	1 November 2015	1 May 2016

The outstanding awards granted to each Executive Director under the SIP are as follows:

Name	Total number of matching shares as at 1 January 2013	Total number of partnership shares awarded in the year	Total number of matching shares as at 31 December 2013
Alex Bevis	–	317	317
Ted Wiggans	–	317	317
Richard Barham	–	317	317
Ramon Borrell	–	317	317

Payments made to former Directors during the year

Phil Eaves resigned from the Board in March 2012 and ceased employment with the Company in June 2012. In respect of Mr Eaves' unvested long term incentive awards under the LTIP granted on 22 November 2010 and 11 April 2011, the Remuneration Committee exercised discretion and determined that he would be treated as a 'good leaver' under the terms of the plan. The number of shares which vested on 22 November 2013 was determined by applying the original performance conditions and reducing the number granted on 22 November 2010 to reflect his length of service during the performance period. Phil Eaves has one outstanding LTIP award, which is due to vest on 11 April 2014. The number of shares vesting will be determined by applying the original performance conditions and reduced on a pro-rata basis to reflect his length of service during the performance period.

Payments for loss of office made during the year

No payments for loss of office have been made to Directors during the year ended 31 December 2013.

Performance graph and table

The graph on page 53 shows the Company's performance measured by total shareholder return (TSR), compared with the performance of the FTSE TechMARK All Share Index and the FTSE 250, which the Remuneration Committee considers to be the most appropriate indices for comparison because they illustrate the Company's TSR performance against a broad equity market index of similar UK companies.

Total shareholder return £

Source: Datastream (Thomson Reuters)

This graph shows the value, by 31 December 2013, of £100 invested in Xaar plc on 31 December 2008 compared with the value of £100 invested in the FTSE TechMARK All Share Index or the FTSE 250.

The table below shows details of the total remuneration and annual bonus and LTIP paid out to Ian Dinwoodie over the last five financial years.

	Total remuneration	Annual bonus as a % of maximum opportunity	LTIP as a % of maximum opportunity
Year ended 31 December 2013	1,379	83%	100%
Year ended 31 December 2012	649	53%	100%
Year ended 31 December 2011	1,244	100%	100%
Year ended 31 December 2010	504	80%	32%
Year ended 31 December 2009	229	0%	0%

Directors' remuneration report continued

CEO pay increase in relation to all employees

The table below sets out in relation to salary, taxable benefits and annual bonus the increase between the pay for the year ended 31 December 2012 and the pay for the year ended 31 December 2013 for Ian Dinwoodie compared with the average increase between the same periods for the wider workforce. For the purposes of the table below, the wider workforce has been defined as the UK employees of the Group. This comparator group was chosen because it is the most relevant sub-set of employees and can be used consistently.

Element of remuneration	Ian Dinwoodie/ % change	Wider workforce average/ % change
Salary	12%	3%
Benefits	6%	3%
Annual bonus	76%	34%
Overall	35%	6%

Spend on pay

The table below sets out the Group's distributions to shareholders by way of dividends and total Group-wide expenditure on pay for all employees (including employer social security, pension contributions and share-based payments), as reported in the audited financial statements for the financial year ended 31 December 2013.

	2013 (£'000)	2012 (£'000)
Dividends paid to shareholders	**4,059**	2,174
Group-wide expenditure on pay for all employees	**35,770**	26,858

Implementation of Directors' remuneration policy for the financial year commencing 1 January 2014

Information on how the Company intends to implement the policy for the financial year commencing 1 January 2014 is set out below.

The fundamental structure of the package remains unchanged and we are not changing the annual bonus opportunity, deferred bonus matching and long term incentive opportunity or defined contribution rate for pensions.

Basic salary and fees

Our approach on base salary continues to be to provide a fixed remuneration component which reflects the experience and capabilities of the individual in the role, the demonstrated performance of the individual in the role, and which is competitive in the markets in which we operate.

The Group has grown significantly over the last few years. Over this period of substantial growth, base salaries have increased but have remained below lower quartile compared with both FTSE Small Cap and FTSE 250 companies. The Remuneration Committee has therefore resolved to move base salaries progressively, over a three year period, to a level which is market competitive (in general, positioned towards the lower end of the market range). The proposed base salary increases for the Executive Directors with effect from 1 January 2014 are shown below:

Year ended 31 December	**2013**	2014	% increase
Ian Dinwoodie	**£232,000**	£260,000	12%
Alex Bevis	**£151,000**	£169,000	12%
Ted Wiggans	**£162,000**	£183,000	13%
Richard Barham	**£166,000**	£183,000	10%
Ramon Borrell[1]	**£145,000**	N/A	N/A

[1] Ramon Borrell will step down from the Board on 1 April 2014.

Edmund Creutzmann will join the Board as Chief Technical Officer from 1 April 2014.

The Remuneration Committee will reassess the intended increases in 2015 and 2016 and consider whether it remains appropriate at that time.

The Non-Executive Directors' fees have also been reviewed by the Board during the year and the Board has resolved to move the Non-Executive Directors' fees towards the lower end of the market competitive range over the next three years. The fees for the Non-Executive Directors with effect from 1 January 2014 are set out below:

Year ended 31 December	2013	2014	% increase
Phil Lawler (Chairman)	£80,000	£90,000	13%
David Cheesman	£35,000	£39,000	11%
Robin Williams	£38,000	£42,000	11%

Annual bonus

The Remuneration Committee has reviewed the performance metrics and targets for the annual bonus to ensure that they remain appropriately stretching in the current environment and continue to be aligned with the business strategy. No changes to the quantum, performance conditions or performance targets are proposed.

The Board considers the Group profit target for 2014 to be a matter that is commercially sensitive and should therefore remain confidential to the Company. It provides our competitors with insight into our business plans, expectations and, in the case of individual performance, our strategic actions. However, the Remuneration Committee may disclose on a retrospective basis how the Company's performance relates to any annual bonus payments made.

Long term incentives

No changes to the quantum, performance conditions or performance targets are proposed. The current LTIP rules (which also include the provisions which govern the Matching Share Awards) expire in April 2017. The Remuneration Committee intends to review the structure of the package and operation of the incentive arrangements and will seek shareholder approval for any new plans prior to this date. However, in the meantime, in line with best practice, the Remuneration Committee will introduce in 2014:

- a 1 x salary shareholding guideline for Executive Directors who will have until the fifth anniversary of appointment to build this level of shareholding, and
- a malus provision, for future awards under the long term incentive plan, to allow the committee to adjust unvested Matching Share Awards and unvested Performance Share Awards in the event of material misstatement, material failure of risk management or serious reputational damage.

Consideration by the Directors of matters relating to Directors' remuneration

Membership

The Company has established a Remuneration Committee which is constituted in accordance with the recommendations of the UK Corporate Governance Code. The terms of reference of the Remuneration Committee can be obtained by contacting the Company Secretary.

The Remuneration Committee is chaired by David Cheesman and its other members during the year ended 31 December 2013 were Phil Lawler and Robin Williams. All members of the Remuneration Committee are considered independent within the meaning of the UK Corporate Governance Code.

Directors' remuneration report continued

The principal function of the Remuneration Committee is to determine, on behalf of the Board, the specific remuneration and other benefits of Executive Directors, including pension contributions, bonus arrangements, long term incentives and service contracts. The fees paid to the Non-Executive Directors are determined by the Chief Executive Officer and the Chairman. The fees paid to the Chairman are determined by the Chief Executive Officer and the Non-Executive Directors.

Additionally, the Remuneration Committee makes recommendations to the Board on the framework of Executive Director remuneration as well as principal company-wide compensation programmes.

The members of the Remuneration Committee have no personal financial interest, other than as shareholders, in the matters to be decided, no actual or potential conflicts of interest arising from other directorships and no day to day operational responsibility within the Company. Executive Directors are entitled to accept appointments outside the Group providing that the Chairman's permission is sought.

Advisors to the Remuneration Committee

The Remuneration Committee is assisted in its work by the Head of Human Resources. Ian Dinwoodie, Chief Executive Officer, and Alex Bevis, Finance Director, also assisted the Remuneration Committee during the year. The Chief Executive Officer is consulted on the remuneration of those who report directly to him and also of other senior executives. No Executive Director or employee is present or takes part in discussions in respect of matters relating directly to their own remuneration.

During the year, the Remuneration Committee was assisted in its work by the following external consultants:

Advisor	Details of appointment	Services provided by the advisor	Fees paid by the Company for advice to the Remuneration Committee and basis of charge	Other services provided to the Company in the year ended 31 December 2013
PricewaterhouseCoopers LLP (PwC)	Appointed by the Board in 2013	General advice on remuneration matters Benchmarking	£25,000 Charged on a fixed fee basis	Corporate tax advice
Deloitte LLP (Deloitte)	Appointed by the Remuneration Committee in 2013 following a competitive tender process	Advice on developments in executive pay and the operation of the Company's incentive plans Benchmarking Advice on market practice and shareholder perspectives Advice on the new reporting regulations in connection with the disclosure of Directors' remuneration	£21,225 Charged on a time/cost basis or fixed fee dependent on nature of project	External auditor and certain other services (see page 89 of the annual report)

The Remuneration Committee took into account the Remuneration Consultants Group's Code of Conduct when reviewing the appointment of PwC and Deloitte and also took into account Deloitte's role as external auditor. As Deloitte are external auditor to the Company, Deloitte's advice to the Remuneration Committee is governed by certain guidelines and safeguards.

The Remuneration Committee is satisfied that the remuneration advice provided by both PwC and Deloitte is objective and independent.

Shareholder voting

The Company remains committed to ongoing shareholder dialogue and takes an active interest in voting outcomes. The following table sets out actual voting in respect of the resolution to approve the Directors' remuneration report for the year ended 31 December 2012.

Number of votes	For (including discretion)	Against	Withheld
Directors' remuneration report for the year ended 31 December 2012	55,840,898 (97.01%)	1,722,583 (2.99%)	1,473,033

Directors' remuneration report continued

Directors' remuneration policy

This part of the report sets out the Company's Directors' remuneration policy, which, subject to shareholder approval at the 2014 AGM, shall take binding effect from the date of that meeting. The policy is determined by the Remuneration Committee.

The Directors' remuneration policy is not audited.

Policy table for Executive Directors

The table below describes each of the elements of the remuneration package for the Executive Directors:

Alignment with strategy/purpose	Operation
Base salary Core element of fixed remuneration that provides the basis to recruit and retain talent necessary to deliver the business strategy.	Normally reviewed annually, any increases generally apply from 1 January (but may be reviewed more frequently if required). When determining base salary levels, consideration is given to the following: • Role, responsibility and experience of the individual • Corporate and individual performance • Market conditions including typical pay levels for comparable roles in companies of a similar size and complexity • The range of salary increases awarded across the Group.
Benefits Provide a market-competitive benefits package to recruit and retain Directors of the calibre required for the business. Participation in the Company's Share Incentive Plan ("SIP") and Share Save Scheme ("SAYE") encourages share ownership and alignment with the wider workforce.	Executive Directors receive base benefits including car allowance (or company car), private medical insurance, and basic levels of other insurances (such as critical illness cover). All UK staff, including Executive Directors, are also provided with a benefit allowance which they can apply to a range of benefits, including pension contributions. In some circumstances, and subject to Remuneration Committee approval, the allowance may be paid in cash rather than utilised to purchase benefits. The SIP and SAYE are HMRC approved share plans for all employees facilitating the acquisition of shares in the Company at a discount. Other benefits may be provided based on individual circumstances, such as, but not limited to: housing or relocation allowances, travel allowance or other expatriate benefits.
Retirement benefits Provide market competitive post-employment benefits to recruit and retain Directors of the calibre required for the business.	Executive Directors are eligible to participate in the defined contribution pension scheme (or such other pension plan as may be deemed appropriate). In appropriate circumstances, Executive Directors may take a salary supplement instead of contributions into a pension plan.
Annual bonus Rewards performance against annual targets which support the strategic direction of the Company. The majority of staff participate in the same scheme.	Targets are set annually and any pay-out is determined by the Remuneration Committee after the period-end, based on performance against those targets. The Remuneration Committee has discretion to vary the bonus pay-out should any formulaic output not produce a fair result for either the Executive Director or the Company, taking account of the Remuneration Committee's assessment of overall business performance. The annual bonus is delivered in cash. Executive Directors may choose to invest the bonus earned (on a post-tax basis) in bonus investment shares, in return for participation in the bonus matching element of the LTIP – see below for further details. Bonus investment shares are beneficially owned by the individual and are not subject to forfeiture. Additionally Directors may opt to invest in the Company SIP (refer to note 32 for details).

Maximum opportunity	Performance measures
No maximum salary opportunity has been set out in this policy report to avoid setting expectations for Executive Directors and employees. The base salaries effective as at 1 January 2014 are shown on page 54. The Remuneration Committee has resolved to move base salaries progressively to a level which is market competitive (in general, positioned towards the lower end of the market range) taking account of individual factors such as: • increase in scope and responsibility • a new Executive Director being moved to market positioning over time • alignment to market level.	Not applicable.
Whilst the Remuneration Committee has not set an absolute maximum on the level of benefits Executive Directors receive, the value of benefits is set at a level which the Remuneration Committee considers to be appropriately positioned taking into account relevant market levels based on the nature and location of the role and individual circumstances. The flexible benefits allowance is currently up to 5% of base salary. The Remuneration Committee has the authority to review and amend this rate as appropriate. Individuals have the choice to invest all or part of this amount in their pension scheme, in addition to the benefits outlined in the 'Retirement benefits' section of this table. SAYE and SIP limits as permitted in accordance with the relevant tax legislation.	Not applicable.
Current rates are 11% of base salary for the Chief Executive Officer and 10% of base salary for the other Executive Directors. The Remuneration Committee has the authority to review and amend this rate as appropriate.	Not applicable.
Overall maximum annual bonus 133% of salary. **Financial performance:** The Company profit performance element has a linear relationship with adjusted profit before tax. The pay-out has the following parameters: Below threshold performance: 0% of salary. On-target performance: 50% of salary. Maximum: 100% of salary. The bonus is then subject to a multiplier in the range of 0-1.33 which is applied to reflect individual performance, where 1.0 is used for 'on-target' individual performance.	Stretching performance targets are set each year reflecting the business priorities that underpin Group strategy. 100% of salary can be earned based on achieving these performance targets.

Directors' remuneration report continued

Alignment with strategy/purpose	Operation
Long Term Incentive Plan Drive and reward the achievement of longer term objectives aligned closely to shareholders' interests. Retain key executives over a longer term measurement period. Provide alignment with shareholders' interests. Supports retention and promotes share ownership. Malus applies to enable the Company to mitigate risk.	The LTIP was approved by shareholders in April 2007 and comprises two elements: Performance Share Awards and Matching Share Awards. **Performance Share Awards:** are usually made on an annual basis and will vest subject to the achievement of performance conditions. **Matching Share Awards:** as described above, Executive Directors may choose to invest the bonus earned (on a post-tax basis) in bonus investment shares, in return for the opportunity to earn a Matching Share Award subject to the achievement of performance conditions. For both elements of the LTIP, awards of conditional shares, restricted stock or nil cost options can be made with vesting dependent on the achievement of performance conditions, normally over a three year performance period. Vested LTIP options must be exercised within ten years of the date of grant. Under the rules of the LTIP, the Remuneration Committee has discretion to satisfy vested LTIP awards in cash. On the vesting/exercise of an LTIP award, the Remuneration Committee has the discretion to decide that executives can receive an amount (in cash or shares) equal to the dividends paid or payable between the date of grant and the vesting of an award on the number of shares which have vested. Awards may vest early on a change of control (or other relevant event) subject to the satisfaction of the performance conditions (as determined by the Remuneration Committee) and pro-rating for the LTIP was approved by shareholders in April 2007 and comprises two elements: Matching Share Awards and Performance Share Awards. In 'good leaver' circumstances the Remuneration Committee has the discretion to allow all or part of unvested awards to be retained by the individual. For awards granted on or after 1 January 2014, the Remuneration Committee has the right to reduce any LTIP awards which have not yet vested (i.e. a malus provision) if an act or omission contributes to a material misstatement of the Group's financial statements or results in material loss or reputational damage for the Company. The Remuneration Committee may at its discretion structure awards as Approved Long Term Incentive Plan ('ALTIP') awards. ALTIP awards enable the participant and Company to benefit from HMRC approved option tax treatment in respect of part of the award, without increasing the pre-tax value delivered to participants. ALTIP awards may be structured either as an approved option for the part of the award up to the HMRC limit (currently £30,000) with an unapproved option for the balance and a 'linked award' to fund the exercise price of the approved option, or as an approved option and an LTIP award, with the vesting of the LTIP award scaled back to take account of any gain made on the exercise of the approved option. Other than to enable the grant of ALTIP awards, the Company will not grant awards to Executive Directors under the Executive Share Option Plan.

Maximum opportunity	Performance measures
Maximum Performance Share Award: 100% of salary. Maximum Matching Share Award: 1 for 1 match on the (pre-tax) value of the bonus used to acquire bonus investment shares (subject to an overall maximum of 100% of salary). For both elements of the LTIP, for threshold performance, 35% of salary will be payable. Straight-line vesting applies between threshold and maximum vesting. These limits do not include the value of shares subject to any approved option granted as part of an ALTIP award.	Stretching performance targets are set each year reflecting the business priorities that underpin longer term Group strategy.

Directors' remuneration report continued

Chairman and Non-Executive Directors

The table below sets out an overview of the remuneration of Non-Executive Directors.

Alignment with strategy/purpose	Approach of the Company
Chairman and Non-Executive Directors' fees Provide an appropriate reward to attract and retain Directors of the calibre required for the business.	The remuneration of the Chairman of the Board is set by the Remuneration Committee and the Chief Executive Officer. Fees are set at a level which reflects the skills, knowledge, and experience of the individual, whilst taking into account appropriate market data. The fee is set as a fixed annual fee and may be paid wholly or partly in cash or Company shares. The Chairman and the Chief Executive Officer are responsible for deciding Non-Executive Directors' fees. Fees are set taking into account several factors, including the size and complexity of the business, fees paid to Non-Executive Directors of UK listed companies of a similar size and complexity, and the expected time commitment and contribution for the role. The fees are set as a fixed annual fee and may be paid wholly or partly in cash or Company shares. Overall fees paid to Directors will remain within the limit stated in our Articles of Association, currently £200,000. The Board has resolved to move the Chairman and Non-Executive Directors' fees progressively to a level which is market competitive (in general, positioned towards the lower end of the market range). Non-Executive Directors do not participate in any incentive scheme. Directors may be eligible to benefits such as the use of secretarial support, travel costs or other benefits that may be appropriate.

Explanation of performance metrics chosen

The annual bonus is assessed against financial targets which are determined by the Remuneration Committee, typically Group adjusted profit before tax. This incentivises Executive Directors to focus on delivering the key financial goals of the Company. The annual bonus multiplier reflects individual performance which is aligned to delivering the overall business strategy and to encourage behaviours which facilitate profitable growth and the future development of the business. These targets therefore ensure that the interests of the Executive Directors are aligned with those of the shareholders.

For the LTIP, long term performance measures are chosen by the Remuneration Committee to provide a robust and transparent basis on which to measure Xaar's performance over the longer term and to provide alignment with Xaar's business strategy. Currently EPS growth is deemed to be the key measure of success of the execution of our long term strategy.

The Remuneration Committee retains the discretion to adjust the performance targets and measures where it considers it appropriate to do so (for example, to reflect changes in the structure of the business and to assess performance on a fair and consistent basis from year to year).

Awards may be adjusted in the event of a variation of capital in accordance with the scheme rules.

Pay policy for other employees

The Company values its wider workforce and aims to provide a remuneration package that is market competitive, complies with any statutory requirements, and is applied fairly and equitably across the wider employee population. Where remuneration is not determined by statutory regulation, the key principles of the compensation philosophy are as follows:

- We remunerate people in a manner that allows for stability of the business and the opportunity for sustainable long term growth
- We seek to remunerate fairly and consistently for each role with due regard to the marketplace, internal consistency and the Company's ability to pay
- The Company operates HMRC approved SIP and SAYE and invites all employees to participate, therefore encouraging wider workforce share ownership.

Illustrations of application of remuneration policy

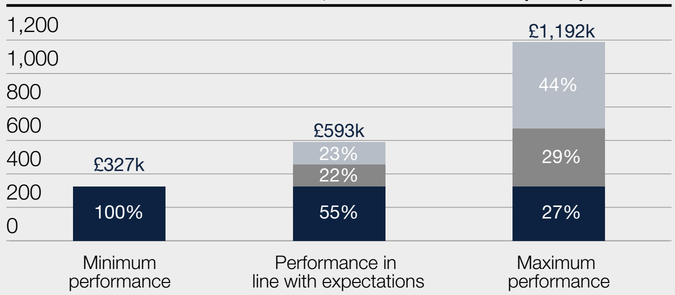
The charts below set out an illustration of the remuneration policy for 2014 in line with the policy above and include base salary, pension, benefits and incentives. The charts provide an illustration of the proportion of total remuneration made up of each component of the policy and the value of each component.

For these purposes base salary is the latest known salary as at 1 January 2014 and benefits is as disclosed in the single figure table on page 46 for the year ended 31 December 2013. Pension is based on the policy set out in the future policy table and base salary effective at 1 January 2014.

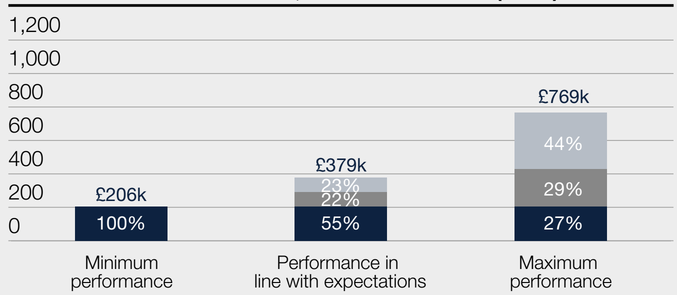
Three scenarios have been illustrated for each Executive Director.

Minimum performance	• No bonus pay-out • No vesting under the LTIP
Performance in line with expectations	• 50% of salary pay-out under the annual bonus • Assume bonus earned invested in bonus investment shares and shares equivalent to 17.5% of salary vesting under the Matching Share Award element of the LTIP (i.e. 50% of salary equal to gross bonus invested x 35% Matching Share Award vesting) • Shares equivalent to 35% of salary vesting under the LTIP
Maximum performance	• 133% of salary pay-out under the annual bonus • Assume maximum investment in bonus investment shares and shares equivalent to 100% of salary vesting under the Matching Share Award element of the LTIP (i.e. 100% of salary equal to gross bonus invested x 100% Matching Share Award vesting) • Shares equivalent to 100% of salary vesting under the Performance Share Award element of the LTIP

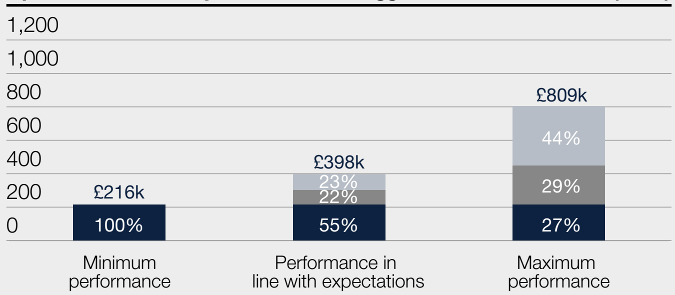
Chief Executive – Ian Dinwoodie, total remuneration (£'000)



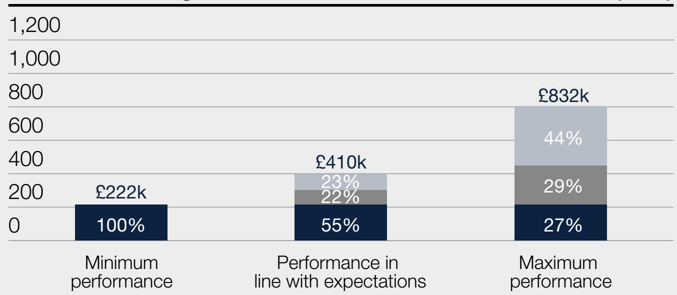
Finance Director – Alex Bevis, total remuneration (£'000)



Operations and Quality Director – Ted Wiggans, total remuneration (£'000)



Sales and Marketing Director – Richard Barham, total remuneration (£'000)



■ Base salary, benefits and pension ■ Annual bonus ■ LTIP and Matching Share Award

Directors' remuneration report continued

As required by the regulations, the scenarios do not include any share price growth assumptions or take into account any dividends that may be paid.

Approach to recruitment remuneration

When appointing a new Executive Director, whether with an internal or external candidate, the Remuneration Committee will typically seek to use the policy detailed in the table on page 63 to determine the Executive Director's ongoing remuneration package.

To facilitate the appointment of candidates of the appropriate calibre required to implement the Group's strategy, the Remuneration Committee also retains the discretion to include any other remuneration component or award which is outside the policy. The Remuneration Committee does not intend to use this discretion to make a non-performance related incentive payment (for example, a 'golden hello'). In determining appropriate remuneration, the Remuneration Committee will take into consideration all relevant factors (including the quantum and nature of remuneration) to ensure that the arrangements are in the best interests of the Company and its shareholders. This may, for example, include (but is not limited to) the following circumstances:

- an interim appointment being made to fill an Executive Director role on a short term basis
- exceptional circumstances require that the Chairman or a Non-Executive Director takes on an executive function on a short term basis
- an Executive Director is recruited at a time in the year when it would be inappropriate to provide a bonus or long term incentive award for that year as there would not be sufficient time to assess performance. The quantum in respect of the months employed during the year may be transferred to the subsequent year so that reward is provided on a fair and appropriate basis
- the executive received benefits at his previous employer which the Remuneration Committee considers it appropriate to offer.

The Remuneration Committee may also alter the performance measures, performance period and vesting period of the annual bonus or long term incentive, subject to the rules of the scheme, if the Remuneration Committee determines that the circumstances of the recruitment merit such alteration. The rationale will be clearly explained.

In determining appropriate remuneration arrangements on hiring a new Executive Director, the Remuneration Committee will take into account relevant factors such as the calibre of the individual, local market practice, the existing remuneration arrangements for other executives and the business circumstances. It will seek to ensure that arrangements are in the best interests of both the Company and its shareholders and seek not to pay more than is appropriate.

The Remuneration Committee may make an award or payment to 'buy-out' remuneration arrangements forfeited on leaving a previous employer. In doing so the Remuneration Committee will take account of relevant factors regarding the forfeited arrangements which may include the form of any forfeited awards (e.g. cash or shares), any performance conditions attached to these awards (and the likelihood of meeting those conditions), and the time over which they would have vested. It will generally seek to structure buy-out awards and payments on a comparable basis to remuneration arrangements forfeited. These awards or payments are excluded from the maximum level of variable pay referred to below; however, the Remuneration Committee's intention is that the value awarded or paid would be no higher than the expected value of the forfeited arrangements.

Appropriate costs and support will be covered if the recruitment requires the relocation of the individual. All buy-out awards and payments will normally be liable to forfeiture or 'clawback' on early departure. For Executive Directors, early departure is typically defined as being within the first two years of employment although the Remuneration Committee has the ability to amend this definition in appropriate circumstances.

The maximum level of variable pay which may be awarded to new Executive Directors, excluding buy-out arrangements, would normally be in line with the maximum level of variable pay that may be awarded under the annual bonus plan and LTIP, but in any event the Remuneration Committee would not make an award of annual variable pay above 283% of salary. The Remuneration Committee may determine that such awards will be forfeited if performance or continued employment conditions are not met and it is deemed appropriate to do so.

Any share awards referred to in this section will be granted as far as possible under the Company's existing share plans. If necessary, and subject to the limits referred to above, in order to facilitate the awards mentioned above, the committee may rely on exemption 9.4.2. of the Listing Rules which allows for the grant of awards to facilitate, in exceptional circumstances, the recruitment of a Director.

Where a position is fulfilled internally, any ongoing remuneration obligations or outstanding variable pay elements shall be allowed to continue according to the original terms.

Fees payable to a newly-appointed Chairman or Non-Executive Director will be in line with the fee policy in place at the time of appointment.

Service contracts

Executive Directors

It is the Group's policy that Executive Directors should have contracts with an indefinite term, providing for one year's notice.

	Date of contract[1]	Date of appointment	Notice from the Company	Notice from Director
Ian Dinwoodie	5 December 2013	13 November 2001	12 months	12 months
Alex Bevis	12 December 2013	14 February 2011	12 months	12 months
Ted Wiggans	4 December 2013	10 January 2011	12 months	12 months
Richard Barham	12 December 2013	5 March 2012	12 months	12 months

[1] The dates of contract above refer to the dates of the latest service agreements for each of the Directors.

Non-Executive Directors

All Non-Executive Directors are appointed for an initial three year term with provision for two further three year terms, subject to satisfactory performance.

	Date of letter of appointment	Date of appointment	Unexpired term of contract on 31 December 2013
Phil Lawler (Chairman)	17 May 2007	1 June 2007	2 years and 5 months
David Cheesman	18 May 2011	4 July 2011	6 months
Robin Williams	3 March 2010	1 March 2010	2 years and 2 months

All Directors offer themselves for annual re-election at each AGM in accordance with the UK Corporate Governance Code. Letters of appointment are available for inspection at the registered office address of the Company.

Payments for loss of office

The principles on which the determination of payments for loss of office will be approached is set out on page 66. Where the Remuneration Committee retains discretion, as outlined below, it will be used to provide flexibility in certain situations, taking into account the particular circumstance of the Director's departure and recent performance of the Company.

Directors' remuneration report continued

Executive Directors

	Policy
Notice period on termination by employing company	12 months. The committee has the discretion to determine what proportion of the notice period will be utilised in active service.
Termination payment	Severance payments are limited to no more than one year's salary plus benefits in kind (including company car or car allowance and private health insurance) and pension contributions (which may include salary supplements). Benefits provided in connection with termination of employment may also include, but are not limited to, outplacement and legal fees.
Vesting of incentives for leavers	The Remuneration Committee has the discretion to determine appropriate bonus amounts taking into consideration the circumstances in which an Executive Director leaves. Typically for 'good leavers' bonus amounts will be determined by reference to the applicable performance targets, pro-rated for time in service to termination and paid at the usual time. The Remuneration Committee may decide to pay a good leaver's bonus earlier than the usual time in appropriate circumstances. 'Good leavers' typically include leavers due to death, illness, injury, disability, redundancy, retirement with the consent of the Company, or any other reason as determined by the Remuneration Committee. The vesting of share-based awards is governed by the rules of the relevant incentive plan, as approved by shareholders. Under the LTIP, the provisions for good leavers provide that awards will vest at the end of the normal vesting period, subject to the satisfaction of the performance conditions. However, the Remuneration Committee has the discretion to accelerate vesting to the date of cessation of employment. If accelerated to the date of cessation of employment, the Remuneration Committee will determine the extent to which the performance conditions are considered satisfied. In either case, the extent to which an award vests will be subject to pro-rating for time (although the Remuneration Committee has discretion not to apply time pro-rating). In circumstances other than good leavers, awards will lapse. Were a buy-out award is to be made under Listing Rule 9.4.2 then the leaver provisions would be determined at the time of the award. Payments may be made under the Company's SAYE and SIP which are governed by HMRC approved plan rules and which cover certain leaver provisions.

Non-Executive Directors

Under the terms of their engagement, the notice period to be given by the Non-Executive Directors on the Company is six months and the Company is obliged to give the same length of notice. Discretion is retained to terminate with or without due notice or paying any payment in lieu of notice dependent on what is considered to be in the best interests of the Company in the particular circumstances.

Statement of consideration of employment conditions elsewhere in the Company

Salary, benefits and performance related reward provided to employees is taken into account when setting policy for Executive Directors' remuneration (although employees are not formally consulted in relation to the setting of the policy). This includes consideration of:

- salary increases for the general employee population
- company-wide benefit (including pension) offerings
- overall spend and participation levels in the annual bonus and LTIP, and
- relevant ad-hoc information.

Existing contractual arrangements

The Remuneration Committee reserves the right to make any remuneration payments and payments for loss of office notwithstanding that they are not in line with the policy set out below where the terms of the payment were agreed:

(i) before the policy came into effect, or
(ii) at a time when the relevant individual was not a Director of the Company and, in the opinion of the Remuneration Committee, the payment was not in consideration for the individual becoming a Director of the Company.

For these purposes 'payments' includes the Remuneration Committee satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment are 'agreed' at the time the award is granted.

The Remuneration Committee may make minor changes to this policy, which do not have a material advantage to Directors, to aid in its operation or implementation without seeking shareholder approval but taking into account the interests of shareholders.

Statement of consideration of shareholder views

In the interests of ensuring ongoing and transparent dialogue with shareholders, the Remuneration Committee consulted major shareholders on changes to the Executive Director base salaries and Non-Executive fees for 2014. There were no other significant changes to the Directors' remuneration policy proposed for 2014.

Approval

This Report was approved by the Board on 18 March 2014 and signed on its behalf by:

David Cheesman
Remuneration Committee Chairman
18 March 2014

Directors' responsibilities statement

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates that are reasonable and prudent
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance, and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position, and profit or loss of the company and the undertakings included in the consolidation taken as a whole
- the strategic report includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face, and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's performance, business model, and strategy.

By order of the Board

Ian Dinwoodie
Chief Executive

Alex Bevis
Finance Director and Company Secretary
18 March 2014

Independent auditor's report to the members of Xaar plc

Opinion on financial statements of Xaar plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2013 and of the Group's profit for the year then ended
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Reconciliation of Adjusted Financial Measures, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity, the Consolidated Cash Flow Statement and the related notes 1 to 34, and the Parent Company Balance Sheet and the related notes 1 to 10. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Going concern

As required by the Listing Rules we have reviewed the Directors' statement in the Directors' report that the Group is a going concern. We confirm that:

- we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independent auditor's report to the members of Xaar plc continued

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team:

Risk	How the scope of our audit responded to the risk
Inventory valuation We consider there to be a significant risk with respect to the valuation of raw materials, work-in-progress and finished goods at all stages of the assembly process owing to the judgemental nature of determining the costs used in the inventory standard costing model. The inventory provision, which is based on review of old and obsolete inventory lines in addition to historic evidence of inventory write-offs, is also considered to be a significant risk owing to the judgmental nature of the inventory provision.	We tested the inventory standard costing valuation methodology to assess whether it is determined in accordance with International Accounting Standard 2 (IAS 2). This has included testing the controls in relation to the inventory standard costing system, such as the review of variance reports, and the data generated by that system. We challenged the assumptions used in the derivation of the cost absorption rates through performing independent checks against actual costs for the year and comparing cost absorption rates with prior years for consistency. Our testing assessed the reasonableness of the amendments to inventory valuation for changes in actual costs of production. We tested the completeness and accuracy of the year end inventory valuation, assessing whether standard costs have been applied appropriately to items of raw materials, work-in-progress and finished goods. We tested the inventory provision for completeness by reference to inventory damage/obsolesence issues identified through interviews with inventory management personnel external to the finance function. We challenged the assumptions that underlie the provision and substantiated via reference to third party transactions and evidence.
Revenue recognition The Xaar Group accounts for revenue on printheads and system components at the point of despatch as this is the point at which the risks and rewards of the products held as stock are transferred to the customer. The Group has no significant distribution/consignment agreements in place with third parties. We consider there to be a significant risk with respect to the accounting for customer contract pricing with Xaar's significant customers owing to the degree of estimation involved in accounting for contract pricing and the associated revenue in line with IFRSs and the Group's accounting policy.	When auditing revenue streams we considered the Group's revenue recognition policy, per International Accounting Standard 18 'Revenue' (IAS 18), to assess whether revenue recognition is acceptable under IFRSs and whether the policy has been applied consistently through the year. We performed testing over customer contract pricing agreements granted to customers during the year by testing a sample of these agreements, reviewing the terms and conditions of sale and agreeing the accounting treatment and revenue recognition applied; also ensuring compliance with IFRSs. For the most significant customers we obtained the customer contract pricing agreement and reconciled this to the accounting treatment per the financial statements.

Risk	How the scope of our audit responded to the risk
Capitalisation of internally generated intangible assets We consider there to be a significant risk in relation to development costs being incorrectly recognised through the profit or loss during the year, in contravention of IAS 38. Owing to the quantum of investment in R&D in the year and the number of R&D projects to be approaching technical and economic feasibility, the failure to capitalise appropriate costs could result in material misstatement of profit and loss for the year.	We challenged management's accounting treatment of development costs by reviewing research and development project costs and discussing those projects with significant expenditure with the Research and Development Director, in order for us to assess whether projects have reached the development phase and therefore require capitalisation. For each project we made an assessment of the technical feasibility and likelihood of future economic benefit by reference to product test stage classifications and communications with the markets.
Warranty provision There are two components to the warranty provision, a general provision (based on the historic product return rate over a twelve month period) and a specific provision. We consider there to be a significant risk with respect to the completeness and valuation of the specific warranty provision owing to the judgemental nature of the provision calculations which are estimated with reference to known product issues which have arisen during the year.	We performed a review of sales returns to identify any specific warranty issues that have arisen over the course of the year. All specific issues identified are included in the specific provision. We discussed warranty issues with staff external to finance and challenged estimates and assumptions when our wider audit procedures indicated to us that product issues may exist that have yet to be updated for in the warranty provision calculation. In addition, we assessed the current year warranty provision by reference to historic product return reports and the accuracy of the prior year provision. We also agreed all known issues back to the specific warranty calculation.
Depreciation of property, plant and equipment (PPE) As a result of the growth of the business and resulting expansion of the Huntingdon manufacturing facility, £19.4 million of PPE additions had been recognised during the year ended 31 December 2013. The depreciation of PPE has been considered to be a significant audit risk due to the judgemental nature of the point at which depreciation commences and the potentially material effect if accounted for the incorrect accounting period.	We tested a sample of PPE additions and transfers from 'assets under construction' (on which no depreciation is charged) to 'live' assets categories in order to assess whether depreciation has commenced when the asset was available for use, in accordance with International Accounting Standard 16 'Property, Plant and Equipment' (IAS 16).

Independent auditor's report to the members of Xaar plc continued

The Audit Committee's consideration of these risks is set out on page 40.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the group to be £1.9 million, which is below 5% of pre-tax profit.

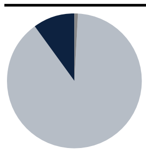
We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £40,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our Group audit scope primarily on the audit work at the UK headquarters in Cambridge. Five entities were subject to a full audit (Xaar plc, XaarJet Ltd, Xaar Technology Ltd, XaarJet (Overseas) Ltd and Xaar Digital Ltd) performed directly by the Group audit team. Three entities (XaarJet AB, Xaar Group AB and Xaar America Inc.) were subject to specified audit procedures where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations at those locations. The eight entities subject either to a full audit or specified audit procedures account for 100% of the Group's net assets, 100% of the Group's revenue and 100% of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work for each entity was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

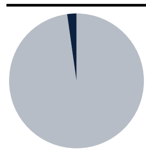
At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances. As the Group auditor we planned the work conducted by the component auditor, reviewed their work and attended conference call audit planning, status update and close meetings.

Revenue %



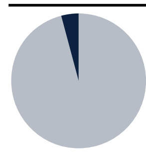
Review at Group level	1%
Full audit scope	89%
Specified audit procedures	10%

Profit before tax %



Full audit scope	98%
Specified audit procedures	2%

Net assets %



Full audit scope	96%
Specified audit procedures	4%

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records	Under the Companies Act 2006 we are required to report to you if, in our opinion: • we have not received all the information and explanations we require for our audit; or • adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or • the parent company financial statements are not in agreement with the accounting records and returns. We have nothing to report in respect of these matters.
Directors' remuneration	Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.
Corporate governance statement	Under the Listing Rules we are also required to review the part of the corporate governance statement relating to the company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.
Our duty to read other information in the annual report	Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is: • materially inconsistent with the information in the audited financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading. In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.
Respective responsibilities of Directors and auditor	As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews. This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.
Scope of the audit of the financial statements	An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

David Halstead FCA
(Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditor
Cambridge, United Kingdom

18 March 2014

Consolidated income statement
for the year ended 31 December 2013

	Notes	2013 £'000	2012 £'000
Revenue	4	**137,128**	86,304
Cost of sales		**(63,114)**	(45,356)
Gross profit		**74,014**	40,948
Research and development expenses		**(16,389)**	(8,032)
Research and development expenditure credit		**586**	–
Sales and marketing expenses		**(6,114)**	(5,346)
General and administrative expenses		**(12,398)**	(12,022)
Operating profit		**39,699**	15,548
Investment income	4, 8	**443**	186
Finance costs	9	**(55)**	(33)
Profit before tax		**40,087**	15,701
Tax	10	**(8,226)**	(3,073)
Profit for the year attributable to shareholders	6	**31,861**	12,628
Earnings per share			
Basic	12	**43.3p**	17.5p
Diluted	12	**41.6p**	16.9p

Dividends paid in the year amounted to £4,059,000 (2012: £2,174,000). Further disclosures are given in note 11.

All activities relate to continuing operations.

Consolidated statement of comprehensive income
for the year ended 31 December 2013

	Note	2013 £'000	2012 £'000
Profit for the year attributable to shareholders		**31,861**	12,628
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on retranslation of net investment	28	**(7)**	(150)
Other comprehensive loss for the year		**(7)**	(150)
Total comprehensive income for the year		**31,854**	12,478

Reconciliation of adjusted financial measures

for the year ended 31 December 2013

	2013 £'000	2012 £'000
Revenue	**137,128**	86,304
Non-recurring royalty income	**(2,994)**	–
Adjusted revenue	**134,134**	86,304

	2013 £'000	2012 £'000
Profit before tax	**40,087**	15,701
Share-based payment charges	**4,204**	1,542
Exchange differences relating to the Swedish operations	**416**	(262)
(Gain)/loss on derivative financial instruments	**(9)**	4
Non-recurring royalty income	**(2,994)**	–
Research and development expenditure credit	**(586)**	–
Impairment of trade investments and associated loans	**–**	1,401
Adjusted profit before tax	**41,118**	18,386

Share-based payment charges include the IFRS 2 charge for the period of £2,103,000, per note 32 (2012: £1,358,000) and the charge relating to National Insurance on the outstanding potential share option gains of £2,101,000 (2012: £184,000).

Exchange differences relating to the Swedish operations represent exchange gains or losses recorded in the consolidated income statement as a result of operating in Sweden.

(Gain)/loss on derivative financial instruments relates to gains and losses made on forward contracts in 2013 and 2012.

Non-recurring royalty income relates to the settlement of under-reported royalties payable by licensees for the period 2006 to 2012.

The research and development expenditure credit relates to the corporation tax relief receivable relating to qualifying research and development expenditure.

The charge for the impairment of trade investments in 2012 relates to a minority stake in an inkjet solutions provider and a convertible loan. The full value of these investments was recognised as an impairment loss in the income statement in the period, within administrative expenses.

	2013 Pence per share	2012 Pence per share
Diluted earnings per share	**41.6p**	16.9p
Share-based payment charges	**5.5p**	2.1p
Exchange differences relating to the Swedish operations	**0.5p**	(0.3p)
Non-recurring royalty income	**(3.9p)**	–
Impairment of trade investments and associated loans	**–**	1.9p
Tax effect of adjusting items	**(0.5p)**	(0.5p)
Adjusted diluted earnings per share	**43.2p**	20.1p

This reconciliation is provided to enable a better understanding of the Group's results and is not a primary statement.

Financial statements

Consolidated statement of financial position

as at 31 December 2013

	Notes	2013 £'000	2012 £'000
Non-current assets			
Goodwill	13	**720**	720
Other intangible assets	14	**3,387**	4,015
Property, plant and equipment	15	**38,452**	26,704
Investments	17	**1,000**	–
Deferred tax asset	21	**4,308**	946
		47,867	32,385
Current assets			
Inventories	18	**15,285**	13,203
Trade and other receivables	19	**15,441**	12,487
Current tax asset	19	**782**	654
Treasury deposits	19	**22,000**	4,000
Cash and cash equivalents	19	**31,485**	25,446
Derivative financial instruments		**6**	–
		84,999	55,790
Total assets		**132,866**	88,175
Current liabilities			
Trade and other payables	22	**(19,225)**	(10,399)
Other financial liabilities	23	**(57)**	(655)
Current tax liabilities		**(1,848)**	(854)
Provisions	24	**(1,074)**	(1,629)
Derivative financial instruments		**–**	(4)
		(22,204)	(13,541)
Net current assets		**62,795**	42,249
Non-current liabilities			
Deferred tax liabilities	21	**(328)**	(286)
Other financial liabilities	23	**(292)**	(229)
Total non-current liabilities		**(620)**	(515)
Total liabilities		**(22,824)**	(14,056)
Net assets		**110,042**	74,119
Equity			
Share capital	25	**7,589**	7,474
Share premium	26	**25,484**	24,406
Own shares	27	**(4,066)**	(4,215)
Other reserves	29	**8,610**	6,507
Translation reserve	28	**350**	357
Retained earnings	29	**72,075**	39,590
Equity attributable to shareholders		**110,042**	74,119
Total equity		**110,042**	74,119

The financial statements of Xaar plc, registered number 3320972, were approved by the Board of Directors and authorised for issue on 18 March 2014.

They were signed on its behalf by:

Ian Dinwoodie
Chief Executive

Alex Bevis
Finance Director and Company Secretary

Consolidated statement of changes in equity

for the year ended 31 December 2013

	Notes	Share capital £'000	Share premium £'000	Own shares £'000	Other reserves £'000	Translation reserve £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2012		7,280	23,727	(4,465)	5,149	507	29,171	61,369
Profit for the year		–	–	–	–	–	12,628	12,628
Exchange differences on retranslation of net investment		–	–	–	–	(150)	–	(150)
Total comprehensive income for the period		–	–	–	–	(150)	12,628	12,478
Issue of share capital		194	679	–	–	–	(90)	783
Own shares sold in the period		–	–	250	–	–	–	250
Dividends	11	–	–	–	–	–	(2,174)	(2,174)
Deferred tax on share option gains		–	–	–	–	–	55	55
Credit to equity for equity settled share-based payments		–	–	–	1,358	–	–	1,358
Balance at 1 January 2013		**7,474**	**24,406**	**(4,215)**	**6,507**	**357**	**39,590**	**74,119**
Profit for the year		**–**	**–**	**–**	**–**	**–**	**31,861**	**31,861**
Exchange differences on retranslation of net investment		**–**	**–**	**–**	**–**	**(7)**	**–**	**(7)**
Total comprehensive income for the period		**–**	**–**	**–**	**–**	**(7)**	**31,861**	**31,854**
Issue of share capital		**115**	**1,078**	**–**	**–**	**–**	**(46)**	**1,147**
Own shares sold in the period		**–**	**–**	**149**	**–**	**–**	**(24)**	**125**
Dividends	11	**–**	**–**	**–**	**–**	**–**	**(4,059)**	**(4,059)**
Tax on share option gains		**–**	**–**	**–**	**–**	**–**	**4,753**	**4,753**
Credit to equity for equity-settled share-based payments		**–**	**–**	**–**	**2,103**	**–**	**–**	**2,103**
Balance at 31 December 2013		**7,589**	**25,484**	**(4,066)**	**8,610**	**350**	**72,075**	**110,042**

Consolidated cash flow statement
for the year ended 31 December 2013

	Note	2013 £'000	2012 £'000
Net cash from operating activities	30	**45,093**	19,896
Investing activities			
Investment income		**278**	186
Acquisition of investment bonds		**(1,000)**	–
Purchases of property, plant and equipment		**(16,713)**	(7,541)
Proceeds on disposal of property, plant and equipment		**42**	560
Expenditure on capitalised product development and software		**(245)**	(345)
Net cash used in investing activities		**(17,638)**	(7,140)
Financing activities			
Dividends paid		**(4,059)**	(2,174)
Treasury deposits		**(18,000)**	(4,000)
Proceeds from the sale of ordinary share capital		**125**	250
Proceeds from issue of ordinary share capital		**1,147**	783
Finance costs		**(55)**	(35)
Repayments of borrowings		**(594)**	(277)
Net cash used in financing activities		**(21,436)**	(5,453)
Net increase in cash and cash equivalents		**6,019**	7,303
Effect of foreign exchange rate changes on cash balances		**20**	(131)
Cash and cash equivalents at beginning of year		**25,446**	18,274
Cash and cash equivalents at end of year		**31,485**	25,446

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. The carrying amount of these assets is approximately equal to their fair value.

Notes to the consolidated financial statements

for the year ended 31 December 2013

1. General information

Xaar plc ('the Company') is incorporated in England and Wales under the Companies Act 2006. The address of the registered office is given on the inside back cover. The nature of the Group's operations and its principal activity is set out in the Strategic report starting on page 2.

2. Key sources of estimation uncertainty and critical accounting judgements

The key assumptions concerning the future and other sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

Asset valuations

Throughout the year, management considers the carrying value of both receivables and inventory balances. Provisions against both balances are made on the basis of past losses, current trading patterns and anticipated future events.

Provisions

Management regularly consider the potential liabilities which may arise from product warranty claims, commercial disputes, restructuring or other activities which may result in future losses or charges. Management create and maintain appropriate financial provisions based on specific known issues and underlying historical experience.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the 'value-in-use' of the cash-generating units to which the goodwill is allocated. Estimating a value-in-use amount requires management to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2013 was £720,000 (2012: £720,000). Further details are given in note 13.

Impairment of trade investments

The Group determines whether its trade investments are impaired at least on an annual basis. Unquoted investments are evaluated against the opportunity for return through trading gains as a result of continuing to hold the investment. An impairment review of trade investments was performed in 2012 and the carrying value of the trade investment held was deemed to be fully impaired and therefore as at 31 December 2012 and 2013 the carrying value was £nil. Further details are given in note 17.

3. Significant accounting policies

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS'), as adopted for use in the European Union. Therefore the Group financial statements have been prepared in accordance with Article 4 of the EU IAS regulation.

The financial information has been prepared on the basis of all applicable IFRS, including all International Accounting Standards ('IAS'), Standing Interpretations Committee ('SIC') interpretations and International Financial Reporting Interpretations Committee ('IFRIC') interpretations issued by the International Accounting Standards Board ('IASB') that are applicable to the financial period, as adopted by the European Union.

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. The Group financial statements are presented in sterling and all values are rounded to the nearest thousand pounds (£'000) except when otherwise indicated.

The principal accounting policies adopted are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company ('its subsidiaries') made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used in line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation. Foreign exchange gains and losses arising on the retranslation of trading balances with subsidiaries with different functional currencies are reported in the income statement.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the strategic report on pages 8 to 11. Notes 19, 20 and 23 include a description of the Group's objectives; policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Group has considerable financial resources and through a diverse customer base is exposed not only to the Western economies but also China, India and Latin America. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future, based on the Group's forecasts and projections for the next four years, taking account of reasonably possible changes in trading performance. For this reason, we continue to adopt the going concern basis in preparing the financial statements.

Notes to the consolidated financial statements continued
for the year ended 31 December 2013

3. Significant accounting policies continued

Business combinations

The acquisition of subsidiaries is accounted for using the acquisition method.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the income statement.

Goodwill

Goodwill arising on consolidation is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of the cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes, but gross of any tax withheld.

Sales of goods are recognised when all of the following conditions are satisfied:

- the Company has transferred to the buyer the significant risks and rewards of ownership of the goods
- the Company retains neither a continuing managerial involvement to the degree normally associated with ownership, nor effective control over goods sold
- the amount of revenue can be measured reliably
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred, or to be incurred, in respect of the transaction can be measured reliably.

For sales of goods to a distributor with consignment stock arrangements, revenue is recognised at the point of sale by the distributor which is when the risks and rewards of ownership of inventory have transferred.

Development fees gained from joint development agreements are treated as income over the periods necessary to match them with the related costs.

Funding received for internally generated intangible assets is recognised on a straight-line basis to match the amortisation period of the related intangible fixed asset.

Royalties are recognised on an accruals basis in accordance with the actual revenue trend in the most recent quarterly statements received from each licensee.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Leases

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease, except where another more systematic basis is more representative of the time pattern in which the economic benefits from the lease asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

3. Significant accounting policies continued

Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group company are expressed in sterling, which is the functional currency of the Company and the presentation currency for the consolidated financial statements.

Exchange differences arising on the settlement of monetary assets and liabilities, and on the retranslation of monetary assets and liabilities, are included in the income statement for the period.

In order to hedge its exposure to certain foreign exchange risks, the Group may enter into forward contracts (see page 83 for details of the Group's accounting policies in respect of such derivative financial instruments).

For the purposes of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at the exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising are recognised in other comprehensive income and taken to the translation reserve. Exchange differences on the translation of net investments are taken to the translation reserve of the applicable entity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The Group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRS as sterling denominated assets and liabilities.

Government and EU grants

Government and EU grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attached to them and that the grant will be received.

Government and EU grants relating to research and development are treated as income over the periods necessary to match them with the related costs.

Operating profit

Operating profit is stated after charging restructuring costs but before investment income and finance costs.

Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. Payments made to state managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax, including UK corporation tax and foreign tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

To the extent that the Group receives a tax deduction relating to share-based payment transactions, deferred tax is provided at the appropriate tax rate on the difference in value between the market price of the underlying equity as at the date of the financial statements and the exercise price of the outstanding share options. As a result, the deferred tax impact of share options will not be derived directly from the expense reported in the consolidated income statement. The amount by which the deductible difference exceeds the cumulative charge to the consolidated income statement is recorded in the consolidated statement of comprehensive income.

3. Significant accounting policies continued

Taxation continued

Deferred tax assets and liabilities are measured on an undiscounted basis and are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Property, plant and equipment

All property, plant and equipment is shown at original historical cost less accumulated depreciation and any recognised impairment loss.

Assets in the course of construction for production or administrative purposes are carried at cost, less any recognised impairment loss. Depreciation of these assets, on the same basis as other assets in the same class, commences when the assets are ready for their intended use.

Depreciation is charged so as to write off the cost or valuation of assets, less their residual values, other than assets in the course of construction, over their estimated useful lives, using the straight-line method, on the following bases:

Leasehold property improvements	ten years or, where shorter, over the term of the relevant lease
Plant and machinery	three to five years
Furniture, fittings and equipment	three to five years
Motor vehicles	three years

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

The gain or loss arising on the disposal of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

Internally generated intangible assets – research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

In accordance with IAS 38 'Intangible assets' where a project has entered the development phase and is sufficiently self-contained that the expected future economic benefits can be traced directly to the assets developed within the project, it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity, and the cost of the asset can be measured reliably, the development costs related to the project will be capitalised as an intangible asset.

Internally generated intangible assets are amortised on a straight-line basis over their useful lives. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Other intangible assets

Costs incurred in maintaining the patent and trademark portfolio are written off to the income statement as incurred.

Payments in respect of software, external product development costs and licence rights acquired are capitalised at cost and amortised on a straight-line basis over their estimated useful lives.

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value-in-use. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss is subsequently reversed, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the first in, first out (FIFO) cost formula, by applying the standard cost methodology, with costs including direct materials, direct labour costs and an attributable proportion of manufacturing overheads based on normal levels of activity that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution. Provision is made for obsolete, slow-moving or defective items where applicable.

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

3. Significant accounting policies continued

Trade receivables

Trade receivables are measured at initial recognition at fair value. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Investments

Investments are recognised and derecognised on a trade date where a purchase or sale of an investment is under a contract whose terms require delivery of the investment within the time frame established by the market concerned and are initially measured at fair value, equating to cost, including transaction costs. Investments are classified as available for sale, and on the basis that the investments have no active market and their fair values cannot be reliably determined using valuation techniques, the investments are carried at cost.

If there is objective evidence that an impairment loss on an unquoted equity investment that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Bonds with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortised cost using effective interest method less any impairment.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short term highly liquid investments that are readily convertible to a known amount of cash within a period of up to three months post balance sheet and are subject to an insignificant risk of changes in value.

Treasury deposits

Treasury deposits comprise demand deposits that are convertible to a known amount of cash with an original maturity of up to twelve months, which are due to mature more than three months after the balance sheet date and are subject to an insignificant risk of changes in value.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out within the policy on derivative financial instruments and hedge accounting below.

Interest-bearing loans and borrowings

Interest-bearing loans and bank overdrafts are measured initially at fair value, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis in the income statement using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Trade payables

Trade payables are measured at original cost.

Equity instruments

Equity instruments issued by the Company are recorded as the proceeds received, net of direct issue costs.

Derivative financial instruments and hedge accounting

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates and liquidity risk.

The Group uses derivative financial instruments (primarily foreign currency forward contracts) to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecast transactions.

The Group's interest rate risk arises mainly from its funds invested in short term bank deposits. To mitigate these risks, limits have been set by the Board in relation to maturity period and maximum deposits with any one institution.

In order to mitigate the Group's liquidity risks, the Group can choose to fund significant fixed asset purchases by finance leases repayable over a period of three to five years dependent on the individual asset being financed and interest-bearing loans.

The use of financial derivatives is governed by the Group's policies approved by the Board of Directors, which provides written principles on the use of financial derivatives consistent with the Group's risk management strategy. The Group does not use derivative financial instruments for speculative purposes.

Derivative financial instruments are initially measured at fair value on the contract date and are remeasured to fair value at subsequent reporting dates.

Changes in the fair value of derivative financial instruments that are designated as hedges of future cash flows and deemed to be effective are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. If the cash flow hedge of a firm commitment or forecast transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects net profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or non-financial liability, the gains and losses previously accumulated in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

3. Significant accounting policies continued

Derivative financial instruments and hedge accounting continued

Changes in fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value, with gains or losses reported in the income statement.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date and are discounted where the effect of the time value of money is material.

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it, and the plan has reached a stage where the decision is unlikely to be reversed. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

Provisions for the expected cost of warranty obligations under local sale of goods legislation are recognised in the month of sale of the relevant products, at the Directors' best estimate of the expenditure required to settle the Group's obligation.

Share-based payments

The Group has applied the requirements of IFRS 2 'Share-based payment'. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 January 2005.

The Group issues equity-settled share-based payments to certain employees. These payments are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

The fair value of options issued under the Group's Long Term Incentive Plan is measured using a stochastic (Monte Carlo binomial) model for grants made between 2007 and 2009 inclusive. The fair value of all other equity-settled share-based payments is measured using the Black-Scholes pricing model. The expected life used in these models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

SAYE share options granted to employees are treated as cancelled when employees cease to contribute to the scheme. This results in accelerated recognition of the expenses that would have arisen over the remainder of the original vesting period.

Own shares

Own shares are deducted from equity. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of the Group's own shares.

3. Significant accounting policies continued

New standards and interpretations

In the current year, the following new and revised Standards and Interpretations have been adopted:

- IFRS 7 (amended) 'Disclosures – Offsetting Financial Assets and Financial Liabilities'

As the Group does not have any offsetting arrangements in place, the application of the amendments has had no impact on the disclosures or on the amounts recognised in the consolidated financial statements.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 9	Financial Instruments
IFRS 10, IFRS 12 and IAS 27 (amended)	Investment Entities
IAS 36 (amendments)	Recoverable Amount Disclosures of Non-Financial Assets
IAS 39 (amendments)	Novation of Derivatives and Continuation of Hedge Accounting
IFRIC Interpretation 21	Levies

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods.

4. Revenue

An analysis of the Group's revenue is as follows:

	Note	2013 £'000	2012 £'000
Product sales, commissions and fees		**127,210**	80,091
Royalties		**9,918**	6,213
		137,128	86,304
Investment income	8	**443**	186
		137,571	86,490

Notes to the consolidated financial statements continued

for the year ended 31 December 2013

5. Business and geographical segments

Products and services from which reportable segments derive their revenues.

For management reporting purposes, the Group's operations are currently analysed according to the two operating segments of 'product sales, commissions and fees' and 'royalties'. These two operating segments are the basis on which the Group reports its primary segment information and on which decisions are made by the Group's Chief Executive Officer and Board of Directors, and resources allocated. The Group's chief operating decision maker is the Chief Executive Officer.

Segment information is presented below:

Year ended 31 December 2013	Product sales, commissions and fees £'000	Royalties £'000	Unallocated £'000	Consolidated £'000
Revenue				
Total segment adjusted revenue	127,210	6,924	–	134,134
Non-recurring royalty income	–	2,994	–	2,994
Revenue	127,210	9,918	–	137,128
Result				
Adjusted profit before tax	33,806	6,924	388	41,118
Non-recurring royalty income	–	2,994	–	2,994
Share-based payment charges	–	–	(4,204)	(4,204)
Exchange differences relating to the Swedish operations	(416)	–	–	(416)
Gain on derivative financial instruments	–	–	9	9
Research and development expenditure credit	586	–	–	586
Profit/(loss) before tax	33,976	9,918	(3,807)	40,087

Investment income and finance costs are not allocated to reportable segments for the purposes of reporting to the Group's Chief Executive Officer and Board of Directors.

Share-based payment charges include the IFRS 2 charge for the period and the charge relating to National Insurance on the outstanding potential share option gains.

Year ended 31 December 2012	Product sales, commissions and fees £'000	Royalties £'000	Unallocated £'000	Consolidated £'000
Revenue				
Total segment revenue	80,091	6,213	–	86,304
Result				
Adjusted profit before tax	12,020	6,213	153	18,386
Share-based payment charges	–	–	(1,542)	(1,542)
Exchange differences relating to the Swedish operations	262	–	–	262
Loss on derivative financial instruments	–	–	(4)	(4)
Impairment of trade investments	–	–	(1,401)	(1,401)
Profit/(loss) before tax	12,282	6,213	(2,794)	15,701

5. Business and geographical segments continued

Segment assets

	2013 £'000	2012 £'000
Product sales, commissions and fees	**76,812**	57,526
Royalties	**1,563**	1,203
Total segment assets	**78,375**	58,729
Investments	**1,000**	–
Treasury deposits	**22,000**	4,000
Cash and cash equivalents	**31,485**	25,446
Derivative financial instruments	**6**	–
Total assets	**132,866**	88,175

Assets are allocated to the segment which has responsibility for their control.

No information is provided for segment liabilities as this measure is not provided to the chief operating decision maker.

Other segment information

Year ended 31 December 2013	Notes	Product sales, commissions and fees £'000	Royalties £'000	Unallocated £'000	Consolidated £'000
Depreciation and amortisation	14, 15	**8,299**	**–**	**–**	**8,299**
Share-based payment charges		**–**	**–**	**4,204**	**4,204**
Capital expenditure	14, 15	**19,750**	**–**	**–**	**19,750**

Year ended 31 December 2012	Notes	Product sales, commissions and fees £'000	Royalties £'000	Unallocated £'000	Consolidated £'000
Depreciation and amortisation	14, 15	7,386	–	–	7,386
Share-based payment charges		–	–	1,542	1,542
Capital expenditure	14, 15	7,322	–	–	7,322

Revenues from major products and services

	2013 £'000	2012 £'000
Product sales, commissions and fees	**127,210**	80,091
Royalties	**9,918**	6,213
Consolidated revenue (excluding investment income)	**137,128**	86,304

Notes to the consolidated financial statements continued

for the year ended 31 December 2013

5. Business and geographical segments continued

Geographical information

The Group operates in three principal geographical areas: EMEA, Asia and the Americas. The Group's revenue from external customers and information about its segments (non-current assets excluding deferred tax assets and other financial assets) by geographical location is detailed below:

	Revenue from external customers	
	2013 £'000	2012 £'000
EMEA	**67,494**	49,959
Asia		
– China	**50,270**	21,134
– Japan	**10,398**	6,414
– Other	**2,101**	2,461
The Americas (including USA)	**6,865**	6,336
	137,128	86,304

Revenues are attributed to geographical areas on the basis of the customers' operating location.

	Non-current assets	
	2013 £'000	2012 £'000
EMEA	**47,773**	32,316
Asia	**90**	61
The Americas (including USA)	**7**	8
	47,870	32,385

Non-current assets, being property, plant and equipment, goodwill, other intangible assets, investments and the deferred tax asset, are attributed to the location where they are situated.

Information about major customers

Included in revenues arising from product sales, commissions and fees are revenues of approximately £18.6 million (14% of revenues) (2012: £9.3 million, 11% of revenues) which arose from sales to the Group's largest customer. In the year ended 31 December 2013 revenues of approximately £13.2 million (10% of revenues) (2012: £5.7 million, 7% of revenues) were included in the product sales, commissions and fees which arose from sales to the Group's second largest customer. In 2013 and 2012, only the largest customer exceeded 10% of revenue in the period. Revenue from the top five customers represents 45% of revenues (2012: 34%).

6. Profit for the year

Profit for the year has been arrived at after charging/(crediting):

	2013 £'000	2012 £'000
Net foreign exchange losses/(gains) (including exchange differences relating to the Swedish operations)	**262**	(95)
Research and development expenses	**16,389**	8,032
Grants towards research and development including the research and development expenditure credit	**(595)**	(63)
Depreciation of property, plant and equipment	**7,410**	6,648
Amortisation of intangible assets included in administrative expenses	**889**	738
Loss on disposal of property, plant and equipment	**250**	661
Cost of inventories recognised as expense	**63,114**	45,356
Impairment of other financial assets	**215**	172
Impairment of trade investments	**–**	1,401
Total fees payable to the Company's auditor and its associates	**250**	187

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6. Profit for the year continued

	2013 £'000	2012 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	22	19
Fees payable to the Company's auditor and its associates for other services to the Group		
The audit of the Company's subsidiaries	111	85
Total audit fees	133	104
– Interim review	23	23
– Tax services	46	49
– Recruitment and remuneration services	24	11
– Other services	24	–
Total non-audit fees	117	83
Total fees payable to the Company's auditor and its associates	250	187

The Audit Committee has considered the independence of the auditor in relation to non-audit services throughout the year. A description of the work of the Audit Committee is set out in the corporate governance statement on pages 39 to 41 and includes an explanation of how the auditor's objectivity and independence is safeguarded when non-audit services are provided by the auditor.

The Group paid £10,000 (2012: £7,000) to Cambridge Network Limited, an associate of Deloitte LLP. Cambridge Network is a networking organisation which draws its members from companies and individuals interested in the Cambridge technology industry. Neither Deloitte LLP nor any of its partners receive any financial return from Cambridge Network.

7. Staff costs

The average monthly number of persons employed by the Group including Executive Directors was as follows:

	2013 Number	2012 Number
Research and development	105	71
Sales and marketing	57	47
Manufacturing and engineering	465	332
Business support	65	52
	692	502

Their aggregate remuneration comprised:

	Notes	2013 £'000	2012 £'000
Wages and salaries		26,949	21,754
Social security costs		3,521	2,715
Pension costs	33	1,096	847
Share-based payments		4,204	1,542
		35,770	26,858

Share-based payment charges include the IFRS 2 charge for the period and the charge relating to National Insurance on the outstanding potential share option gains.

8. Investment income

	2013 £'000	2012 £'000
Interest receivable on cash and bank balances, and treasury deposits	439	186
Interest receivable on held-to-maturity investments	4	–
	443	186

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9. Finance costs

	2013 £'000	2012 £'000
Interest payable on bank loans and overdrafts	55	–
Interest payable on obligations under finance leases	–	33
	55	33

10. Tax

	Note	2013 £'000	2012 £'000
Current tax – UK		7,843	3,197
Current tax – overseas		263	379
		8,106	3,576
Amounts under/(over)provided in previous years		66	(249)
Total current income tax		8,172	3,327
Deferred tax – origination and reversal		(270)	(26)
Adjustment in respect of prior years		324	(228)
Total deferred tax charge/(credit)	21	54	(254)
Total tax expense for the year		8,226	3,073

The blended standard rate of tax for the year, based on the UK standard rate of corporation tax, is 23.25% (2012: 24.5%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

The Finance Act 2013, which provides for reductions in the main rate of corporation tax from 23% to 21% effective from 1 April 2014 and to 20% effective from 1 April 2015, was substantively enacted on 2 July 2013. These rate reductions have been reflected in the calculation of deferred tax at the balance sheet date.

In 2013, the Company benefited from the enhanced tax deduction for research and development expenditure for three months of the year under the large company scheme, compared with the full year 2012 under the SME scheme. The Company has opted into the research and development expenditure credit scheme from 1 April 2013, which is not a tax deduction and is taken as income included in operating profit.

The charge for the year can be reconciled to the profit per the income statement as follows:

	2013 £'000	2012 £'000
Profit on ordinary activities before tax	40,087	15,701
Tax on ordinary activities at a blended standard rate of 23.25% (2012: 24.5%)	9,319	3,847
Effect of:		
Expenses not deductible for tax purposes	254	519
Effect of different tax rates of subsidiaries operating overseas	59	106
Enhanced tax deduction for patent box	(1,805)	–
Enhanced tax deduction for research and development expenditure	(134)	(948)
Effect of change in UK corporation tax rate	143	26
Prior period adjustments	390	(477)
Total tax expense for the year	8,226	3,073

The effective tax rate for the year is 21% (2012: 20%).

11. Dividends

	2013 £'000	2012 £'000
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2012 of 3.0p (2011: 2.0p) per share	**2,211**	1,446
Interim dividend for the year ended 31 December 2013 of 2.5p (2012: 1.0p) per share	**1,848**	728
Total distributions to equity holders in the year	**4,059**	2,174
Proposed final dividend for the year ended 31 December 2013 of 5.5p (2012: 3.0p) per share	**4,174**	2,242

The proposed final dividend is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

12. Earnings per ordinary share – basic and diluted

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

	2013 £'000	2012 £'000
Earnings		
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	**31,861**	12,628
Number of shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	**73,652,808**	72,151,589
Effect of dilutive potential ordinary shares:		
Share options	**2,989,912**	2,414,068
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**76,642,720**	74,565,657

	2013 Pence per share	2012 Pence per share
Basic	**43.3p**	17.5p
Diluted	**41.6p**	16.9p

The weighted average number of ordinary shares for the purposes of basic earnings per share is calculated after the exclusion of ordinary shares in Xaar plc held by Xaar Trustee Ltd and the Xaar plc ESOP trust.

For 2013, there were no anti-dilutive share options at the period end. For 2012, there were share options granted over 477,752 shares that had not been included in the diluted earnings per share calculation because they were anti-dilutive at the period end.

For 2012, the performance conditions for share options granted over 35,191 shares were not met and therefore the dilutive effect of the number of shares which would have been issued at the period end was not included in the diluted earnings per share calculation. There were no comparable anti-dilutive options or LTIPs to exclude from the current period diluted earnings per share calculation.

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12. Earnings per ordinary share – basic and diluted continued

Adjusted earnings per share

This adjusted earnings per share information is considered to provide a fairer representation of the Group's trading performance year on year, as it removes items which, in the Board's opinion, do not reflect the underlying performance of the Group.

The calculation of adjusted EPS excluding share-based payment charges, exchange differences relating to the Swedish operations, the gain or loss on derivative financial instruments, non-recurring royalty income, and impairment of investments and associated loans is based on earnings of:

	2013 £'000	2012 £'000
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	31,861	12,628
Share-based payment charges	4,204	1,542
Exchange differences relating to the Swedish operations	416	(262)
Loss on derivative financial instruments	(9)	4
Non-recurring royalty income	(2,994)	–
Impairment of investments and associated loans	–	1,401
Tax effect of adjusting items	(376)	(349)
Adjusted profit after tax	33,102	14,964

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

Share-based payment charges include the IFRS 2 charge for the period of £2,103,000, per note 32 (2012: £1,358,000) and the charge relating to National Insurance on the outstanding potential share option gains of £2,101,000 (2012: £184,000).

Adjusted earnings per share is earnings per share excluding the items adjusted for as detailed above:

	2013 Pence per share	2012 Pence per share
Adjusted basic	44.9p	20.7p
Adjusted diluted	43.2p	20.1p

13. Goodwill

The carrying amount of goodwill at 31 December 2013 was £720,000 (2012: £720,000). There were no accumulated impairment losses at the end of the year.

Goodwill acquired in a business combination is allocated, at acquisition, to the cash-generating units (CGUs) that are expected to benefit from that business combination. The carrying amount of goodwill had been allocated as follows:

	2013 £'000	2012 £'000
Printheads and related products (a single CGU)	720	720

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired.

The recoverable amount of the CGU is determined from a value-in-use calculation. The key assumptions to which the value-in-use calculation is most sensitive are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period.

The Group prepares cash flow forecasts derived from the most recent financial forecasts reviewed by management for the next four years and these have been used in the value-in-use calculation. The discount rate applied to the cash flow projections is 8% (2012: 8%) and reflects management's estimate of return on capital employed.

Sensitivity analysis has been completed on each key assumption in isolation and this indicates that reasonable changes in key assumptions on which we have based our determination of the recoverable amount would not cause the carrying amount of goodwill to exceed its recoverable amount.

Having performed impairment testing, no impairment has been identified and therefore no impairment loss has been recognised in either period.

14. Other intangible assets

	Internally generated product development costs £'000	Other product development costs £'000	Licences acquired £'000	Software £'000	Total £'000
Cost					
At 1 January 2012	4,565	4,896	533	2,147	12,141
Additions	–	30	–	315	345
At 1 January 2013	4,565	4,926	533	2,462	12,486
Additions	–	2	–	259	261
At 31 December 2013	**4,565**	**4,928**	**533**	**2,721**	**12,747**
Amortisation					
At 1 January 2012	4,565	1,227	533	1,408	7,733
Charge for the year	–	494	–	244	738
At 1 January 2013	4,565	1,721	533	1,652	8,471
Charge for the year	–	493	–	396	889
At 31 December 2013	**4,565**	**2,214**	**533**	**2,048**	**9,360**
Carrying amount					
At 31 December 2013	**–**	**2,714**	**–**	**673**	**3,387**
At 31 December 2012	–	3,205	–	810	4,015

The amortisation period for software is three to five years and for other development costs incurred on the Group's product development is ten years.

Internally generated product development costs relate to the Platform 2 and Platform 3 ranges of printheads. The amortisation periods of these costs are five to six years.

Licences acquired are amortised over their estimated useful lives which is on average ten years.

At 31 December 2013 the Group had entered into contractual commitments for the acquisition of software amounting to £262,000 (2012: £nil).

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15. Property, plant and equipment

	Leasehold property £'000	Plant and machinery £'000	Furniture, fittings and equipment £'000	Assets in the course of construction £'000	Motor vehicles £'000	Total £'000
Cost						
At 1 January 2012	9,303	36,491	2,529	7,495	26	55,844
Additions	206	1,214	489	5,068	–	6,977
Transfers	223	11,011	41	(11,275)	–	–
Exchange movements	16	86	2	14	–	118
Disposals	(820)	(5,663)	(356)	(26)	(26)	(6,891)
At 1 January 2013	8,928	43,139	2,705	1,276	–	56,048
Additions	1,051	8,121	964	9,353	–	19,489
Transfers	720	504	5	(1,229)	–	–
Exchange movements	(24)	(140)	(7)	(15)	–	(186)
Disposals	(42)	(1,040)	(53)	(122)	–	(1,257)
At 31 December 2013	**10,633**	**50,584**	**3,614**	**9,263**	**–**	**74,094**
Depreciation						
At 1 January 2012	3,743	22,968	1,549	–	26	28,286
Charge for the year	745	5,421	482	–	–	6,648
Exchange movements	18	61	1	–	–	80
Disposals	(812)	(4,489)	(343)	–	(26)	(5,670)
At 1 January 2013	3,694	23,961	1,689	–	–	29,344
Charge for the year	904	5,911	595	–	–	7,410
Exchange movements	(23)	(118)	(6)	–	–	(147)
Disposals	(60)	(852)	(53)	–	–	(965)
At 31 December 2013	**4,515**	**28,902**	**2,225**	**–**	**–**	**35,642**
Carrying amount						
At 31 December 2013	**6,118**	**21,682**	**1,389**	**9,263**	**–**	**38,452**
At 31 December 2012	5,234	19,178	1,016	1,276	–	26,704

As at 31 December 2013 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £6,451,000 (2012: £1,913,000).

16. Subsidiaries

A list of the investments in subsidiaries, including the name, country of incorporation and proportion of ownership interest, is given in note 10 to the Company's separate financial statements.

17. Investments

	2013 £'000	2012 £'000
Trading investments		
At the beginning of the year	–	1,261
Impairment recognised in the year	–	(1,261)
At the end of the year	–	–
Held-to-maturity investments		
At the beginning of the year	–	–
Additions in the year	1,000	–
At the end of the year	1,000	–

The unquoted trading investments represent investments in companies that present the Group with opportunity for return through trading gains.

The charge in 2012 for the impairment of a trade investment relates to a minority stake in an inkjet solutions provider. The full value of this investment was recognised as an impairment loss in the income statement in the prior period, within general and administrative expenses, as the value is no longer deemed recoverable.

Held-to-maturity investments represent investment in bonds returning interest at 3% per annum, which mature on 22 November 2018.

18. Inventories

	2013 £'000	2012 £'000
Raw materials and consumables	5,978	6,775
Work in progress	2,029	1,264
Finished goods	7,278	5,164
	15,285	13,203

19. Other financial assets

The fair value of all financial assets and financial liabilities approximates their carrying value.

Trade and other receivables

	2013 £'000	2012 £'000
Amount receivable for the sale of goods	9,461	7,786
Allowance for doubtful debts	(502)	(287)
	8,959	7,499
Other debtors	5,029	3,605
Prepayments	1,453	1,383
	15,441	12,487
Current tax asset	782	654

No amounts are expected to be settled in more than 12 months.

Trade receivables

The average credit period taken on sales of goods is 24 days (2012: 32 days). No interest is charged on the receivables for the period agreed in the Requirements Contract or, if not specified or applicable, the first 30 days from the date of the invoice. Thereafter, the Group reserves the right to charge interest at a daily rate of the greater of either 3% per annum above the base rate of Barclays Bank plc from time to time, or the maximum rate of interest allowable under the Late Payment of Commercial Debts (Interest) Act 1998, on all sums outstanding until payment in full is received. The Group has provided fully for all receivables over 120 days because historical experience is such that receivables that are past due beyond 120 days are generally not recoverable. Trade receivables between 30 days and 120 days are provided for based on estimated irrecoverable amounts from the sale of goods, determined by reference to past default experience.

Notes to the consolidated financial statements continued

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19. Other financial assets continued

Trade receivables continued

The maximum exposure to credit risk is the carrying amount of the financial assets as disclosed on page 95. Before accepting any new customer, the Group uses an external credit scoring system to assess the potential customer's credit quality and defines credit limits by customer. Credit limits are reviewed at least once per year. Letters of credit may be used. Credit insurance has typically been taken out over the most significant customers. Of the trade receivables balance at the end of the year, seven customers each represented greater than 5% of the total receivables balance, totalling £7.2 million (2012: £5.3 million). The total due from these customers represents 49% (2012: 38%) of the Group's revenue; there are no other customers who represent more than 5% of the total balance of trade receivables.

Included in the Group's trade receivables balance are debtors with a carrying amount of £1.7 million (2012: £1.1 million) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in credit quality and the amounts are still considered recoverable. Of these amounts, the Group is in possession of letters of credit to the value of £1,667,000 (2012: £818,000) which had not reached maturity as at the reporting date. The Group does not hold any other collateral over these balances. The average age of these receivables is 32 days (2012: 34 days).

Ageing of past due but not impaired receivables:

	2013 £'000	2012 £'000
1–30 days overdue	1,726	770
30–60 days overdue	66	469
60–90 days overdue	7	131
90–120 days overdue	–	44
Over 120 days overdue	85	114
Total	1,884	1,528

Movement in the allowance for doubtful debts:

	2013 £'000	2012 £'000
Balance at the beginning of the year	287	155
Impairment losses recognised	215	172
Amounts written off as uncollectible	–	(40)
Balance at the end of the year	502	287

In determining the recoverability of a trade receivable, the Group considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and unrelated. Accordingly, the Directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Ageing of impaired trade receivables:

	2013 £'000	2012 £'000
Current	111	91
1–30 days overdue	23	11
30–60 days overdue	–	7
60–90 days overdue	–	2
90–120 days overdue	1	–
Over 120 days overdue	367	176
Total	502	287

The Directors consider that the carrying amount of trade and other receivables approximates their fair value.

Treasury deposits

Treasury deposits comprise bank deposits with an original maturity of six months or less, which do not mature until more than three months after the balance sheet date. The carrying amount of these assets approximates their fair value.

	2013 £'000	2012 £'000
Treasury deposits	22,000	4,000

19. Other financial assets continued

Cash and cash equivalents

Cash and cash equivalents comprise cash held by the Group and short term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

The analysis of cash and short term bank deposits is as follows:

	2013 £'000	2012 £'000
Cash	**19,485**	17,424
Short term deposits	**12,000**	8,022
	31,485	25,446

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

20. Financial instruments

Categories of financial instruments

Financial assets of £14,770,000 (2012: £11,759,000) are categorised as loans and receivables. Financial liabilities of £22,496,000 (2012: £13,770,000) are categorised as measured at amortised cost. Derivative financial assets and liabilities are derived from quoted prices (unaudited) in active markets for identical assets and liabilities.

Financial risk management objectives

The Group's policy is to manage the Group's financial risk, secure cost effective funding for the Group's operations and to minimise the adverse effects of fluctuations in the financial markets on the value of the Group's financial assets and liabilities, on reported profitability and on the cash flows of the Group.

The Group finances its activities with a combination of bank loans, finance leases, cash and fixed term deposits and forward contracts as deemed appropriate. Other financial assets and liabilities, such as trade debtors and trade creditors, arise directly from the Group's operating activities. The Group also enters into derivative transactions – forward currency contracts. The purpose is to manage the currency risks arising from the Group's operations. It is Group policy that no trading in derivatives shall be undertaken.

Financial instruments give rise to foreign currency, interest rate, credit and liquidity risk. The Group's management of its exposure to credit risk is discussed in note 19 and to liquidity risk is discussed in note 24.

Interest rate risk

The Group's policy is to manage its cost of borrowing using fixed rate debt. Whilst fixed rate interest-bearing debt is not exposed to cash flow interest rate risk, there is no opportunity for the Group to enjoy a reduction in borrowing costs in markets where rates are falling. In addition, the fair value risk inherent in fixed rate borrowing means that the Group is exposed to unplanned costs should debt be restructured or repaid early as part of the liquidity management process.

The sensitivity analysis prepared below relates to cash balances, since borrowings are at fixed rates of interest. The closing cash and cash equivalents, and treasury deposits balance at the year end have been used as the basis for the calculations. A 2% increase or decrease represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 2% higher/lower and all other variables were held constant, the Group's profit for the year ended 31 December 2013 would increase by £1.1 million or decrease by £0.4 million (2012: increase by £0.6 million/decrease by £0.2 million). This is mainly attributable to the Group's exposure to interest rates on its cash balances. There would be no effect on equity reserves.

Foreign currency risk

The Group receives approximately 5% of its revenues in US dollars and 25% of its revenue in Euros, which are partially naturally hedged by supplies in these currencies, but the remainder requires conversion into sterling in order to fund the remaining costs of the UK offices. The Group has a manufacturing facility in Sweden which necessitates the need for the Group to convert sterling into Swedish kronor in order to fund the running costs of this manufacturing facility. The Group may enter into a variety of derivative financial instruments to manage its exposure to foreign currency risk, including forward contracts.

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20. Financial instruments continued

Foreign currency risk continued

The Group is mainly exposed to foreign currency risk resulting from transactions in US dollars, Euros and Swedish kronor. The following table demonstrates the Group's sensitivity to a 10% increase and decrease in the sterling exchange rate against the relevant foreign currencies on the Group's profit before tax and equity (due to changes in the fair value of monetary assets, liabilities and forward currency contracts). 10% represents management's assessment of the reasonably possible movement in exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes inter company balances within the Group where the denomination of the balance is in a currency other than the functional currency of the debtor or the creditor. A positive number below indicates an increase in profit or equity.

	Euro currency impact		US dollar currency impact		Swedish kronor currency impact	
	2013 £'000	2012 £'000	**2013 £'000**	2012 £'000	**2013 £'000**	2012 £'000
Effect of a 10% increase in relevant exchange rate on:						
Profit or loss	**(568)**	(804)	**(195)**	(434)	**(6)**	(3)
Other equity	**–**	–	**13**	24	**83**	(658)
Effect of a 10% decrease in relevant exchange rate on:						
Profit or loss	**694**	983	**238**	531	**7**	3
Other equity	**–**	–	**(16)**	(29)	**(102)**	804

Forward foreign exchange contracts

The Group utilises currency derivatives to hedge significant future transactions and cash flows. The Group does not currently designate its foreign currency denominated debt as a hedging instrument for the purpose of hedging the translation of its foreign operations.

At 31 December 2013, the Group had open currency derivative assets of £6,000 (2012: liabilities £4,000).

As at 31 December 2013 the Group held outstanding forward contracts to cover a proportion of the expected monthly currency exposures for the period January 2014 to February 2014. In total the contracts represented a conversion of €2.4 million into £2.0 million.

Capital risk management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business, maximise shareholder value and provide flexibility for value enhancing investments. The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions or as a result of corporate strategy. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. In addition, any potential value enhancing investments may be funded through additional debt instruments. No changes were made in the objectives, policies or processes during the current or prior year, except for the proposed increase in final dividend for 2013, as detailed in note 11 on page 91.

The Group monitors capital using a gearing ratio, which is determined as the proportion of debt to equity. Debt is defined as long and short term borrowings. Equity includes all capital and reserves of the Group attributable to the equity holders of the parent. The Group's policy for its existing business is to use debt where appropriate, whilst maintaining the gearing ratio at a level under 10%.

The gearing ratio at the year end is as follows:

	2013 £'000	2012 £'000
Bank loans	**–**	(594)
Obligations under finance leases and hire purchase contracts	**–**	–
Net debt	**–**	(594)
Equity	**110,042**	74,119
Gearing ratio	**0%**	1%

The Group is not subject to externally imposed capital requirements.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults.

Trade receivables consist of a large number of customers, spread across different industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

21. Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting periods:

	Accelerated tax depreciation £'000	Cash flow hedges £'000	Share-based payment £'000	Untaxed reserves £'000	Other temporary difference £'000	Total £'000
At 1 January 2012	683	–	(1,331)	356	(59)	(351)
(Credit)/charge to income	(768)	–	646	(76)	(56)	(254)
Credit to equity	–	–	(55)	–	–	(55)
At 1 January 2013	(85)	–	(740)	280	(115)	(660)
Charge/(credit) to income	65	–	130	(50)	(91)	54
Credit to equity	–	–	(3,374)	–	–	(3,374)
At 31 December 2013	**(20)**	**–**	**(3,984)**	**230**	**(206)**	**(3,980)**

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2013 £'000	2012 £'000
Deferred tax liabilities	**328**	286
Deferred tax assets	**(4,308)**	(946)
	(3,980)	(660)

22. Trade and other payables

	2013 £'000	2012 £'000
Trade payables and accruals	**19,225**	10,399

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit taken for trade purchases is 18 days (2012: 34 days).

The Directors consider that the carrying amount of trade payables approximates to their fair value.

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23. Other financial liabilities

Other financial liabilities consist of lease incentives, and in 2012 a bank loan for £594,000.

The borrowings are repayable as follows:

	2013 £'000	2012 £'000
Within one year	**57**	655
In the second year	**57**	41
In the third to fifth years inclusive	**125**	59
Over five years	**110**	129
	349	884
Less: amount due for settlement within twelve months (shown under current liabilities)	**(57)**	(655)
Amount due for settlement after twelve months	**292**	229

The amounts included above are not considered to be materially different from the present value of their carrying amounts.

Liquidity risk

The Group aims to mitigate liquidity risk by managing cash generation by its operations and applying cash collection targets throughout the Group. Investment is carefully controlled, with authorisation limits operating up to Group Board level and cash payback periods applied as part of the investment appraisal process. In this way the Group aims to maintain a good credit rating to facilitate fund raising.

In its funding strategy, the Group's objective is to maintain a balance between continuity of funding and flexibility through the use of overdrafts, bank loans, finance leases and hire purchase contracts. The Group manages liquidity risk by maintaining adequate reserves and banking facilities by continually monitoring cash flows and matching the maturity profiles of financial assets and liabilities.

The Group is inherently a net generator of cash at the operating level. Excess cash used in managing liquidity is only invested in financial instruments exposed to insignificant risk of changes in market value, being placed on interest-bearing deposit with maturities no more than 12 months allowed per the policy. Short term flexibility is achieved by overdraft facilities.

24. Provisions

	Warranty and commercial disputes provision £'000
At 1 January 2012	991
Additional provision in the year	1,780
Utilisation of provision	(893)
Release of provision	(249)
At 1 January 2013	1,629
Additional provision in the year	1,414
Utilisation of provision	(1,306)
Release of provision	(663)
At 31 December 2013	**1,074**

The warranty and commercial disputes provision represents management's best estimate of the Group's liability related to claims against product warranties or commercial sales agreements. The timing of the utilisation of this provision is uncertain.

25. Share capital

	2013 £'000	2012 £'000
Issued and fully paid:		
75,894,829 (2012: 74,738,321) ordinary shares of 10.0p each	**7,589**	7,474

The movement during the year on the Company's issued and fully paid shares was as follows:

	2013 Number	2012 Number	2013 £'000	2012 £'000
At beginning of year	**74,738,321**	72,803,071	**7,474**	7,280
Exercise of share options	**1,156,508**	1,935,250	**115**	194
At end of year	**75,894,829**	74,738,321	**7,589**	7,474

The Company has one class of ordinary shares which carry no right to fixed income.

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

Scheme	Date of grant	Number of shares under option as at 31 December 2013	Number of shares under option as at 31 December 2012	Subscription price per share
Xaar plc 2004 Share Option Plan	20.05.04	**–**	105,000	84.0p
	28.10.04	**–**	95,230	109.0p
	13.04.05	**5,000**	52,962	208.5p
	15.09.05	**17,144**	133,394	274.0p
	21.08.08	**3,500**	55,000	108.25p
	01.04.09	**7,500**	55,000	56.0p
	29.09.09	**–**	5,000	94.5p
	26.08.10	**–**	40,000	149.5p
	22.11.10	**44,175**	230,000	211.0p
	01.06.11	**335,000**	335,000	250.0p
	27.10.11	**25,000**	25,000	243.0p
	01.05.12	**425,000**	430,000	226.5p
	18.10.12	**17,500**	17,500	249.75p
		879,819		
Xaar plc Share Save Scheme	21.12.10	**265,853**	271,893	174.0p
	01.11.11	**123,242**	133,379	212.0p
	01.11.12	**279,422**	291,598	185.0p
	01.11.13	**220,449**	–	616.0p
		888,966	696,870	
Xaar plc Share Incentive Plan	17.04.13	**26,447**	–	0.0p
		26,447		
Total share options outstanding at 31 December		**1,795,232**	2,275,956	

Options granted under the Xaar plc 2004 Share Option Plan are exercisable within three to ten years after the date of the grant. The maximum value of approved options, under the Xaar plc 2004 Share Option Plan, which may be granted to individual employees is £30,000.

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

Options under the Xaar plc Share Incentive Plan are exercisable between three and five years after the date of the grant.

Notes to the consolidated financial statements continued

for the year ended 31 December 2013

25. Share capital continued

Long Term Incentive Plan

Performance Share Awards outstanding under the Xaar plc 2007 Long Term Incentive Plan are as follows:

Date of grant	Number of shares under option as at 31 December 2013	Number of shares under option as at 31 December 2012
01.04.09	–	238,839
22.11.10	–	223,865
11.04.11	299,242	299,242
03.05.11	74,769	74,769
02.04.12	389,084	389,084
01.05.12	183,784	183,784
02.04.13	431,441	–
15.05.13	63,500	–
	1,441,820	1,409,583

All awards under this scheme are exercisable within three to ten years after the date of grant.

26. Share premium account

	£'000
Balance at 1 January 2012	23,727
Premium arising on issue of equity shares	679
Balance at 1 January 2013	24,406
Premium arising on issue of equity shares	1,078
Balance at 31 December 2013	**25,484**

27. Own shares

	£'000
Balance at 1 January 2013	(4,215)
Transfer to share incentive plan	149
Balance at 31 December 2013	**(4,066)**

Of this balance, £20,000 (2012: £20,000) represents 91,250 ordinary shares in Xaar plc held in trust by Xaar Trustee Ltd. Xaar Trustee Ltd was formed in 1995 to act as Trustee to the Employee Benefit Trust established in 1995 to hold shares for the benefit of the employees of the Company and the Group. There has been no movement in the number of shares held in trust by Xaar Trustee Ltd during the year.

The remaining balance of £4,046,000 (2012: £4,195,000) represents the cost of 1,433,901 (2012: 1,486,795) shares in Xaar plc purchased in the market at market value and held by the Xaar plc ESOP trust to satisfy options granted under the Company's share option schemes.

The market value of own shares as at 31 December 2013 was £17,082,000 (2012: £4,411,000).

28. Translation reserve

	£'000
Balance at 1 January 2012	507
Exchange differences on retranslation of net investment	(150)
Balance at 1 January 2013	357
Exchange differences on retranslation of net investment	(7)
Balance at 31 December 2013	**350**

Exchange differences relating to the translation of the net assets of the Group's foreign operations, which relate to subsidiaries only, from their functional currency into the parent's functional currency, being sterling, are recognised directly in the translation reserve.

29. Retained earnings and other reserves

	Notes	Merger reserve £'000	Share-based payments £'000	Other reserves £'000	Total other reserves £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2012		1,105	3,559	485	5,149	29,171	34,320
Net profit for the year		–	–	–	–	12,628	12,628
Share issue related to LTIP awards		–	–	–	–	(90)	(90)
Dividends paid	11	–	–	–	–	(2,174)	(2,174)
Deferred tax asset taken directly to equity		–	–	–	–	55	55
Movement in valuation of share options		–	1,358	–	1,358	–	1,358
Balance at 1 January 2013		1,105	4,917	485	6,507	39,590	46,097
Net profit for the year		–	–	–	–	31,861	31,861
Share issue related to LTIP awards		–	–	–	–	(46)	(46)
Own shares sold in the period		–	–	–	–	(24)	(24)
Dividends paid	11	–	–	–	–	(4,059)	(4,059)
Tax asset taken directly to equity		–	–	–	–	4,753	4,753
Movement in valuation of share options		–	2,103	–	2,103	–	2,103
Balance at 31 December 2013		**1,105**	**7,020**	**485**	**8,610**	**72,075**	**80,685**

The merger reserve and other reserves are not distributable. The merger reserve represents the share premium account in Xaar Technology Limited. The share-based payment reserve represents the cumulative charge made under IFRS 2 in relation to share options and LTIP awards. Other reserves represent the non-distributable portion of the dividend received in Xaar plc from Xaar Digital Limited.

30. Notes to the cash flow statement

	2013 £'000	2012 £'000
Profit before tax	**40,087**	15,701
Adjustments for:		
Share-based payments	**4,204**	1,542
Depreciation of property, plant and equipment	**7,410**	6,648
Amortisation of intangible assets	**889**	738
Impairment loss on trade investments and associated loans	**–**	1,401
Research and development expenditure credit	**(586)**	–
Investment income	**(443)**	(186)
Finance costs	**55**	33
Foreign exchange gains	**(26)**	(275)
(Gains)/losses on forward contracts	**(9)**	4
Loss on disposal of property, plant and equipment	**250**	661
(Decrease)/increase in provisions	**(555)**	639
Operating cash flows before movements in working capital	**51,276**	26,906
Increase in inventories	**(2,121)**	(1,436)
Increase in receivables	**(2,945)**	(3,111)
Increase in payables	**4,091**	840
Cash generated by operations	**50,301**	23,199
Income taxes paid	**(5,208)**	(3,303)
Net cash from operating activities	**45,093**	19,896

Notes to the consolidated financial statements continued

for the year ended 31 December 2013

31. Operating lease arrangements

	2013 £'000	2012 £'000
Minimum lease payments under operating leases recognised as an expense in the year:		
Fixtures, fittings and equipment	**60**	56
Land and buildings	**1,844**	1,673
	1,904	1,729

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	Fixtures, fittings and equipment		Land and buildings	
	2013 £'000	2012 £'000	2013 £'000	2012 £'000
Within one year	**47**	52	**2,148**	1,647
In the second to fifth years inclusive	**41**	48	**5,115**	4,735
After five years	**–**	–	**1,740**	2,824
	88	100	**9,003**	9,206

The operating leases in respect of fixtures, fittings and equipment extend over a period of up to six years.

32. Share-based payments

Equity-settled share option scheme

The Company's share option schemes are open to all employees of the Group. Options are exercisable at a price equal to the average quoted market price of the Company's shares on the date of grant. The standard vesting period is three years.

An option granted under the Xaar plc 2004 Share Option Plan before 2011 will be exercisable over shares with a market value at the date of grant not exceeding a person's annual salary if at the third anniversary of grant the EPS growth of the Company since grant has exceeded the growth in the Retail Prices Indent (RPI) over the same period by at least 12%. To the extent that an option relates to shares with a market value as at the date of grant in excess of a person's annual salary, the option will be exercisable over all of the excess shares if EPS growth over this period has exceeded RPI growth by at least 15%. For EPS performance between these two points, options will be exercisable over the excess shares on a sliding scale. In addition, options can only be exercised if EPS is at least 5.5p for the financial year preceding the third anniversary of grant. Performance may be retested once only from the date of grant to the fourth or fifth anniversary of grant (at the discretion of the Remuneration Committee), but the original EPS growth targets will be increased from 12/15% to 16/20% and 20/25% respectively. The 5.5p target will apply for the final financial year in the extended period.

An option granted under the Xaar plc 2004 Share Option Plan from 2011 onwards will be exercisable over shares with a market value at the date of grant not exceeding a person's annual salary, if at the third anniversary of grant, Xaar plc has achieved positive adjusted profit before tax as shown in the consolidated income statement in the Company's Annual Report and Accounts for any of the three years ending during the vesting period. One third of the shares subject to the option granted rounded to the nearest whole share, will vest based on the performance condition being met per year for each of the three years ending in the vesting period. If the adjusted profit before tax as shown in the consolidated income statement in Xaar plc's Annual Report and Accounts for any relevant year is restated before the option becomes exercisable, the restated figure shall, unless the Remuneration Committee determines otherwise, be applied in determining whether the above targets are met. In addition, options shall only become exercisable in respect of any shares if the committee in its absolute discretion determines that the overall financial performance of Xaar plc over the performance period is satisfactory.

The Xaar 2007 Share Save Scheme provides an opportunity to all UK employees to save a set monthly amount (currently up to £250) over three years towards the exercise of a discounted share option, which is granted at the start of the three years.

The Xaar Share Incentive Plan provides an opportunity for all UK employees to buy shares from their pre-tax remuneration up to the limit permitted by the relevant tax legislation (£1,500 per year for the 2013/2014 tax year) and are awarded additional shares for free on a matching basis; the Company currently operates the plan on the basis of a 1:1 match but may award matching shares up to the maximum ratio permitted by the relevant tax legislation (currently a 2:1 ratio).

Options and awards under the Xaar 2007 Share Save Scheme and Xaar Share Incentive Plan are not subject to performance conditions.

If the options remain unexercised after a period of ten years from the date of grant, or 42 months in the case of the Share Save Scheme, or five years in the case of the Share Incentive Plan (being the contractual lives), the options expire. Save as permitted in the share option scheme rules, options lapse on an employee leaving the Group.

32. Share-based payments continued

Equity-settled share option scheme continued

Details of the share options outstanding during the year are as follows:

	2013 Number of share options	2013 Weighted average exercise price (£)	2012 Number of share options	2012 Weighted average exercise price (£)
Outstanding at beginning of year	**2,275,956**	**1.99**	3,039,987	1.54
Granted during the year	**252,928**	**5.43**	768,962	2.11
Lapsed during the year	**(39,848)**	**2.10**	(372,882)	1.99
Exercised during the year	**(693,804)**	**1.65**	(1,160,111)	0.89
Outstanding at the end of the year	**1,795,232**	**2.60**	2,275,956	1.99
Exercisable at the end of the year	**77,319**	**2.05**	501,586	1.52

The weighted average share price at the date of exercise for share options exercised during the period was £6.42 (2012: £2.38). The options outstanding at 31 December 2013 had a weighted average remaining contractual life of eight years (2012: six years). In 2013, options were granted on 17 April and 1 November. The aggregate of the estimated fair values of the options granted on those dates is £0.78 million. In 2012, options were granted on 1 May, 18 October and 1 November. The aggregate of the estimated fair values of the options granted on those dates is £0.76 million.

The inputs into the Black-Scholes model are as follows:

	2013	2012
Weighted average share price	**£7.38**	£2.29
Weighted average exercise price	**£5.50**	£2.11
Weighted average expected volatility	**42%**	41%
Expected life	**3 years**	5 years
Risk-free rate	**0.94%**	3.16%
Weighted average expected dividends	**0.10%**	0.31%

Expected volatility was determined by calculating the historical volatility of the Group's share price over periods ranging from the previous one to three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Long Term Incentive Plan

The Company's Long Term Incentive Plan is open to all employees of the Group. As at 31 December 2013 all unvested LTIP share awards are subject to the achievement of EPS performance conditions, as follows:

The number of shares that vest will depend on the EPS growth of the Company for the three financial years of the Company commencing on 1 January of the year of grant.

(1) None of the Awards will vest if the Company's EPS growth does not exceed growth in the Retail Prices Index (RPI) by at least 4% compound p.a.

(2) 35% of the Awards will vest if the Company's EPS growth exceeds growth in the RPI by at least 4% compound p.a.

(3) All of the Awards will vest if the Company's EPS growth exceeds growth in the RPI by at least 10% compound p.a.

(4) Awards will vest on a straight-line basis for EPS growth in excess of growth in the RPI of between 4% and 10% compound p.a.

Awards that will vest will be calculated on a straight-line basis.

All awards made under this scheme are exercisable within three to ten years after the date of grant. Save as permitted in the Long Term Incentive Plan rules, awards lapse on an employee leaving the Group.

Key individuals are invited to participate in a bonus matching scheme where matching LTIP share awards are granted when the employee invests their bonus in Xaar shares and retains ownership of these shares for the duration of the LTIP share award vesting period. The matching share award is a 1 for 1 match on the pre-tax value of the bonus used to acquire bonus investment shares. Matching LTIP share awards are subject to the same performance criteria as all other LTIP awards.

32. Share-based payments continued

Long Term Incentive Plan continued

Details of Performance Share Awards outstanding during the year are as follows:

	2013	2012
Awards outstanding at start of year	**1,409,583**	1,790,406
Granted during the year	**496,441**	572,868
Lapsed during the year	**(1,500)**	(48,343)
Exercised during the year	**(462,704)**	(905,348)
Awards outstanding at end of year	**1,441,820**	1,409,583
Exercisable at the end of the year	**–**	238,839

In 2013, Performance Share Awards were made on 2 April and 15 May. The aggregate of the estimated fair values of grants made on those dates is £2.1 million. In 2012, Performance Share Awards were made on 2 April and 1 May. The aggregate of the estimated fair values of grants made on those dates is £1.3 million.

The estimated fair values for 2010 grants onwards were calculated using the Black-Scholes model, whereas the estimated fair value of 2009 grants were calculated using a stochastic (Monte-Carlo binomial) model. The inputs into the Black-Scholes model are as follows:

	2013	2012
Weighted average exercise price	**£nil**	£nil
Weighted average expected volatility	**42%**	41%
Weighted average expected life	**7 years**	7 years
Weighted average expected dividend yield	**0.23%**	0.32%

The Group recognised total expenses of £2,103,000 and £1,358,000 related to all equity-settled share-based payment transactions in 2013 and 2012, respectively.

33. Retirement benefit schemes

Defined contribution schemes

The UK-based employees of the Group's UK companies have the option to be members of a defined contribution pension scheme managed by a third party pension provider. For each employee who is a member of the scheme the Company will contribute a fixed percentage of each employee's salary to the scheme. The only obligation of the Group with respect to this scheme is to make the specified contributions.

The employees of the Group's subsidiaries in Sweden are members of a state managed retirement benefit scheme operated by the Government of Sweden. The subsidiaries are required to contribute a specified percentage of payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefit scheme is to make the specified contributions.

The total cost charged to the income statement in respect of these schemes during 2013 was £1,096,000 (2012: £847,000). As at 31 December 2013 contributions of £191,000 (2012: £100,000) due in respect of the current reporting period had not been paid over to the schemes.

34. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' remuneration report on page 46.

	2013 £'000	2012 £'000
Short term employee benefits	**2,002**	1,751
Post-employment benefits	**88**	87
Share-based payments	**1,039**	829
	3,129	2,667

Company balance sheet (UK GAAP)
as at 31 December 2013

	Notes	2013 £'000	2012 £'000
Fixed assets			
Investments in subsidiaries	3	**12,445**	12,445
Held-to maturity investments	3	**1,000**	–
		13,445	12,445
Current assets			
Debtors – due within one year	4	**65,886**	98,106
Debtors – due after one year	4	**173**	211
Cash at bank and in hand		**21,018**	19,841
		87,077	118,158
Creditors: amounts falling due within one year	5	**(35,653)**	(72,923)
Net current assets		**51,424**	45,235
Total assets less current liabilities		**64,869**	57,680
Net assets		**64,869**	57,680
Capital and reserves			
Called up share capital	6	**7,589**	7,474
Share premium account	6	**25,484**	24,406
Other reserves	6	**25,333**	25,333
Own shares	6	**(4,046)**	(4,195)
Share-based payment reserve	6	**2,047**	1,482
Profit and loss account	6	**8,462**	3,180
Equity shareholders' funds	8	**64,869**	57,680

The financial statements of Xaar plc, registered number 3320972, were approved by the Board of Directors and authorised for issue on 18 March 2014. They were and signed on its behalf by:

Ian Dinwoodie
Chief Executive
18 March 2014

Alex Bevis
Finance Director and Company Secretary

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

Notes to the (UK GAAP) Company balance sheet
for the year ended 31 December 2013

1. Significant accounting policies

Basis of accounting

The separate financial statements of the Company are presented as required by the Companies Act 2006. They have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards and law.

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

The Company has taken advantage of the exemption of FRS 8 "Related party disclosures" not to show transactions with other companies in the Group headed by Xaar plc.

The Company has taken advantage of the exemption in paragraph 2D of FRS 29 'Financial Instruments: Disclosure' and not disclosed information required by that standard as the Group's consolidated financial statements, in which the Company is included, provide equivalent disclosures for the Group under IFRS 7 "Financial Disclosures".

Own shares

Own shares are deducted from equity. No gain or loss is recognised in the profit and loss account on the purchase, sale, issue or cancellation of the Company's own shares.

Share-based payments

The Company has applied the requirements of FRS 20 "Share-based payment". In accordance with the transitional provisions, FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 January 2005.

The Company issues equity-settled share-based payments to certain employees. These payments are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

The fair value of options issued under the Company's Long Term Incentive Plan is measured using a stochastic (Monte Carlo binominal) model for grants made between 2007 and 2009 inclusive. The fair value of all other equity-settled share-based payments is measured using the Black-Scholes pricing model.

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when the timing differences crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets and liabilities are not discounted.

Investments

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

For investments in subsidiaries acquired for consideration, including the issue of shares qualifying for merger relief, cost is measured by reference to the nominal value only of the shares issued. Any premium is ignored.

Bonds with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments and are measured at amortised cost using effective interest method less any impairment.

2. Profit for the year

As permitted by section 408 of the Companies Act 2006, the Company has elected not to present its own profit and loss account for the year. Xaar plc reported a profit for the financial year ended 31 December 2013 of £9,411,000 (2012: £4,342,000), which includes a dividend received from Xaar Technology Limited of £10,000,000 (2012: £6,000,000).

The average number of employees throughout 2013 was 42 (2012: 32). Staff costs amounted to £2.3 million (2012: £2.6 million). Information about the remuneration of Directors is provided in the audited part of the Directors' remuneration report on page 46 of the consolidated financial statements.

The audit fee for the audit of the Company's annual accounts in 2013 was £22,000 (2012: £19,000).

3. Fixed asset investments

	2013 £'000	2012 £'000
Subsidiary undertakings		
At beginning and end of the year	**12,445**	12,445
Held-to-maturity investments		
At beginning of the year	**–**	–
Additions in the year	**1,000**	–
At end of the year	**1,000**	–
Trade investments		
At beginning of the year	**–**	1,261
Impairment loss recognised in the year	**–**	(1,261)
At end of the year	**–**	–

4. Debtors

	2013 £'000	2012 £'000
Amounts receivable within one year		
Amounts owed by Group undertakings	**65,721**	98,003
Prepayments and accrued income	**165**	8
Other debtors	**–**	91
VAT	**–**	4
	65,886	98,106
Amounts receivable after more than one year		
Deferred tax asset	**173**	211
	66,059	98,317

5. Creditors

	2013 £'000	2012 £'000
Amounts falling due within one year		
Amounts owed to Group undertakings	**34,122**	72,578
Accruals	**1,531**	345
	35,653	72,923

For additional disclosures relating to financial liabilities, see note 23 to the consolidated financial statements.

Notes to the (UK GAAP) Company balance sheet continued

for the year ended 31 December 2013

6. Capital and reserves

	Notes	Called up share capital £'000	Share premium account £'000	Other reserves £'000	Own shares £'000	Share-based payments £'000	Profit and loss account £'000	Total £'000
At 1 January 2012		7,280	23,727	25,333	(4,445)	1,086	1,102	54,083
New shares issued		194	679	–	–	–	(90)	783
Own shares sold in the period		–	–	–	250	–	–	250
Dividends paid	7	–	–	–	–	–	(2,174)	(2,174)
Profit for the financial year		–	–	–	–	–	4,342	4,342
Credit to equity for share-based payments		–	–	–	–	396	–	396
At 1 January 2013		7,474	24,406	25,333	(4,195)	1,482	3,180	57,680
New shares issued		115	1,078	–	–	–	(46)	1,147
Own shares sold in the period		–	–	–	149	–	(24)	125
Dividends paid	7	–	–	–	–	–	(4,059)	(4,059)
Profit for the financial year		–	–	–	–	–	9,411	9,411
Credit to equity for share-based payments		–	–	–	–	565	–	565
At 31 December 2013		**7,589**	**25,484**	**25,333**	**(4,046)**	**2,047**	**8,462**	**64,869**

Full details of movements in share capital and the share option schemes are given in note 25 to the consolidated financial statements. The share premium account and other reserves are non-distributable.

7. Dividends

	2013 £'000	2012 £'000
Amounts recognised as distributions to equity holders in the period:		
Final dividend for the year ended 31 December 2012 of 3.0p (2011: 2.0p) per share	**2,211**	1,446
Interim dividend for the year ended 31 December 2013 of 2.5p (2012: 1.0p) per share	**1,848**	728
Total distributions to equity holders in the period	**4,059**	2,174
Proposed final dividend for the year ended 31 December 2013 of 5.5p (2012: 3.0p) per share	**4,174**	2,242

The proposed final dividend is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

8. Reconciliation of movements in shareholders' funds

	2013 £'000	2012 £'000
Profit for the financial year	**9,411**	4,342
Credit to equity for share-based payments	**565**	396
Dividends paid	**(4,059)**	(2,174)
Own shares sold in the period	**125**	250
Share issue of LTIP award	**(46)**	(90)
New shares issued	**1,193**	873
Net addition to shareholders' funds	**7,189**	3,597
Opening shareholders' funds	**57,680**	54,083
Closing shareholders' funds	**64,869**	57,680

9. Share-based payments

Equity-settled share option scheme

The Company's share option schemes are open to all employees of the Company. Options are exercisable at a price equal to the average quoted market price of the Company's shares on the date of grant. The vesting period is three years. The vesting criteria of these options are disclosed in note 32 to the consolidated financial statments. If the options remain unexercised after a period of ten years from the date of grant, 42 months in the case of the Share Save Scheme, or five years in the case of the Share Incentive Plan, the options expire. Save as permitted in the share option scheme rules, options lapse on an employee leaving the Company.

Details of the share options outstanding during the year are as follows:

	2013		2012	
	Number of share options	**Weighted average exercise price (£)**	Number of share options	Weighted average exercise price (£)
Outstanding at beginning of year	**378,372**	**1.66**	566,061	0.98
Granted during the year	**14,067**	**4.54**	94,151	2.20
Lapsed during the year	**(5,054)**	**1.79**	(8,396)	2.06
Exercised during the year	**(189,533)**	**1.12**	(273,444)	0.44
Outstanding at the end of the year	**197,852**	**2.37**	378,372	1.66
Exercisable at the end of the year	**11,875**	**1.89**	148,638	0.93

The weighted average share price at the date of exercise for share options exercised during the period was £5.81 (2012: £2.52). The options outstanding at 31 December 2013 had a weighted average remaining contractual life of six years (2012: five years). In 2013, options were granted on 17 April and 1 November. The aggregate of the estimated fair values of the options granted on those dates is £48,000. In 2012, options were granted on 1 May, 18 October and 1 November. The aggregate of the estimated fair values of the options granted on those dates is £97,000.

The performance conditions relating to the above share options and the exercise prices of options outstanding at the year end are given in note 32 to the consolidated financial statements.

The inputs into the Black-Scholes model are as follows:

	2013	2012
Weighted average share price	**£6.92**	£2.28
Weighted average exercise price	**£4.54**	£2.20
Expected volatility	**42%**	40%
Expected life	**3.71 years**	5.93 years
Risk-free rate	**1.0%**	4.1%
Expected dividends	**0.1%**	0.3%

Expected volatility was determined by calculating the historical volatility of the Company's share price over periods ranging from the previous one to three years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Notes to the (UK GAAP) Company balance sheet continued
for the year ended 31 December 2013

9. Share-based payments continued

Long Term Incentive Plan

The Company's Long Term Incentive Plan is open to all employees of the Company. Vesting of Performance Share Awards made under this scheme is conditional upon the achievement of performance conditions. Full details of the performance conditions are shown in note 32 of the consolidated financial statements. All awards made under this scheme are exercisable within three to ten years after the date of grant. Save as permitted in the Long Term Incentive Plan rules, awards lapse on an employee leaving the Company.

Details of performance share awards outstanding during the year are as follows:

	2013	2012
Awards outstanding at start of year	444,676	679,624
Granted during the year	137,813	208,348
Exercised during the year	(89,573)	(443,296)
Awards outstanding at end of year	492,916	444,676

No LTIP awards were exercisable as at 31 December 2013 (2012: nil).

In 2013, Performance Share Awards were made on 2 April and 15 May. The aggregate of the estimated fair values of grants made on those dates is £0.6 million.

In 2012, Performance Share Awards were made on 2 April and 1 May. The aggregate of the estimated fair values of grants made on those dates is £0.5 million.

	2013	2012
Weighted average exercise price	£nil	£nil
Expected volatility	42%	41%
Expected life	6.5 years	6.5 years
Expected dividend yield	0.2%	0.3%

The Company recognised total expenses of £0.6 million (2012: £0.4 million) related to share-based payment transactions in the year.

10. Subsidiary undertakings

The following entities are wholly owned subsidiary undertakings of the Company:

Name	Country of incorporation	Principal activity	Issued and fully paid up share capital	Proportion of ordinary share capital held by the Company
Xaar Technology Limited	England	Research and development	4,445,322 ordinary shares of £1 each	100%
XaarJet Limited	England	Manufacturing, research and development and sales and marketing	2 ordinary shares of £1 each	100%
XaarJet (Overseas) Limited	England	Sales and marketing	1 ordinary £1 share	100%
Xaar Trustee Limited[1]	England	Trustee	2 ordinary shares of £1 each	100%
Xaar Digital Limited	England	Treasury	1 ordinary £1 share	100%
Xaar Group AB	Sweden	Holding company	1,137,000 ordinary shares of SEK 100 each	100%
XaarJet AB[2]	Sweden	Manufacturing	1,000 ordinary shares of SEK 100 each	100%
Xaar Americas Inc.	USA	Sales and marketing	10,000 shares of common stock US$1 each	100%

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

2 XaarJet AB shares are held by Xaar Group AB.

Five year record

	2013 £'000	2012 £'000	2011 £'000	2010 £'000	2009 £'000
Summarised consolidated results					
Results					
Adjusted revenue	**134,134**	86,304	68,706	54,678	41,497
Adjusted gross profit	**71,020**	40,948	30,379	22,864	16,777
Adjusted profit before tax	**41,118**	18,386	10,566	5,560	2,089
Adjusted profit after tax	**33,102**	14,964	7,922	4,082	2,037
Adjusted diluted earnings per share	**43.2p**	20.1p	10.7p	6.2p	3.3p
Dividends pence per share	**8.0p**	4.0p	3.0p	2.5p	2.5p
Assets employed					
Net cash*	**53,485**	28,853	17,403	21,991	11,080

* Net cash is made up of cash and cash equivalents, treasury deposits less borrowings.

Notice of the Annual General Meeting

Notice is hereby given that the seventeenth Annual General Meeting ('AGM') of Xaar plc (the 'Company') will be held at 316 Science Park, Cambridge CB4 0XR on 14 May 2014 at 9.30am for the following purposes:

Ordinary business

To consider and, if thought fit, pass the following resolutions which will be proposed as Ordinary Resolutions:

1. To receive the Company's annual financial statements for the financial year ended 31 December 2013.
2. To reappoint Deloitte LLP as auditor to hold office from the conclusion of this meeting until the conclusion of the next general meeting of the Company at which financial statements are laid.
3. To authorise the Directors to determine the remuneration of the auditors.
4. To declare a final dividend for the financial year ended 31 December 2013 of 5.5p per ordinary share.
5. To re-elect Richard Barham as a Director.
6. To re-elect Alex Bevis as a Director.
7. To re-elect Edmund Creutzmann as a Director.
8. To re-elect David Cheesman as a Director.
9. To re-elect Phil Lawler as a Director.
10. To re-elect Ted Wiggans as a Director.
11. To re-elect Robin Williams as a Director.
12. To re-elect Ian Dinwoodie as a Director.
13. To approve the Directors' remuneration report (excluding the Directors' remuneration policy set out on pages 58 to 64 of the annual report) for the year ended 31 December 2013.
14. To approve the Directors' remuneration policy, the full text of which is contained in the Directors' remuneration report for the year ended 31 December 2013, as set out on pages 58 to 64 of the annual report, which will take effect immediately after the end of the AGM on 14 May 2014.

Special business

To consider and, if thought fit, pass the following resolutions which will be proposed in the case of Resolutions 15 and 17 as Special Resolutions and in the case of Resolution 16 as an Ordinary Resolution:

15. That the Company be generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 (the 'Act') to make one or more market purchases (within the meaning of section 693(4) of the Act) of ordinary shares of 10p in the capital of the Company (ordinary shares) provided that:
    - the maximum aggregate number of ordinary shares authorised to be purchased is 11,308,329 (representing 14.9% of the issued ordinary share capital);
    - the minimum price (excluding expenses) which may be paid for an ordinary share is the par value of the shares;
    - the maximum price (excluding expenses) which may be paid for an ordinary share is an amount equal to the higher of (i) 105% of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which that ordinary share is purchased, and (ii) the amount stipulated by article 5(1) of the Buy-back and Stabilisation Regulation 2003;
    - this authority shall expire at the conclusion of the next AGM of the Company, or, if earlier, at the close of business on 14 August 2015 unless renewed before that time; and
    - the Company may make a contract to purchase ordinary shares under this authority before the expiry of the authority which will or may be executed wholly or partly after the expiry of the authority, and may make a purchase of ordinary shares in pursuance of any such contract.
16. That, in substitution for all existing authorities including the authority conferred on the Directors by Article 4 (B) of the Company's Articles of Association, in accordance with section 551 of the Act the Directors be and they are generally and unconditionally authorised to exercise all powers of the Company to allot equity securities (within the meaning of section 560 of the Act), or grant rights to subscribe for, or convert any security into, shares in the Company:

    (a) up to an aggregate nominal amount of £5,073,117.73 (such amount to be reduced by the nominal amount of any equity securities allotted pursuant to the authority in Resolution 16(b)) in connection with a rights issue (as defined in the Listing Rules issued by the Financial Conduct Authority pursuant to Part VI of the Financial Services and Markets Act 2000), to holders of equity securities, in proportion to their respective entitlements to such equity securities, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to treasury shares, fractional entitlements, record dates, legal or practical problems in or under the laws of any territory or the requirements of any regulatory body or stock exchange; and

Special business continued

(b) otherwise up to an aggregate nominal amount of £2,536,558.87 (such amount to be reduced by the nominal amount of any equity securities allotted pursuant to the authority in Resolution 16(a)),

provided that this authority shall expire on the conclusion of the Company's AGM in 2015, or, if earlier, at the close of business on 14 August 2015, save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot such equity securities in pursuance of such an offer or agreement as if the authority conferred by this resolution had not expired.

17. Subject to the passing of Resolution 16 of the notice of meeting, that, in substitution for all existing authorities, including the authority conferred on the Directors by Article 4 (C) of the Company's Articles of Association:

(a) the Directors be and they are empowered pursuant to section 570 of the Act to allot equity securities pursuant to the authority conferred by Resolution 16(a) as if section 561 of the Act did not apply to any such allotment, provided that this authority shall be limited to the allotment of equity securities in connection with a rights issue (as defined in the Listing Rules issued by the Financial Conduct Authority pursuant to Part VI of the Financial Services and Markets Act 2000) but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to treasury shares, fractional entitlements, record dates, legal or practical problems in or under the laws of any territory or the requirements of any regulatory body or stock exchange; and

(b) the Directors be and they are empowered pursuant to section 570 of the Act to allot equity securities for cash pursuant to the authority conferred by Resolution 16(b) as if section 561 of the Act did not apply to any such allotment, provided that this authority shall be limited to the allotment of equity securities (otherwise than in connection with any rights issue (as defined in the Listing Rules issued by the Financial Conduct Authority pursuant to Part VI of the Financial Services and Markets Act 2000)) having an aggregate nominal value of up to £380,483.83,

provided that this authority shall expire on the conclusion of the Company's AGM in 2015, or, if earlier, at the close of business on 14 August 2015, save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such an offer or agreement as if the authority conferred by this resolution had not expired.

By order of the Board

Alex Bevis
Company Secretary
18 March 2014

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 show of hands or on a poll, vote instead of him. Where more than one proxy is appointed, each proxy must be appointed to exercise the rights attached to a different share or shares held by the appointing shareholder. 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 or adjourned 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. Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a 'Nominated Person') may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the AGM. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.
4. The statement of the rights of shareholders in relation to the appointment of proxies in paragraphs 1 and 2 above does not apply to Nominated Persons. The rights described in these paragraphs can only be exercised by shareholders of the Company.
5. In accordance with Regulation 41 of the Uncertified Securities Regulations 2001, the Company specifies that only those members entered on the register of members of the Company as at 9.30am on 12 May 2014 (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 9.30am on 12 May 2014 (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.

Notice of the Annual General Meeting continued

6. Copies of Directors' service agreements, the terms of appointment of Non-Executive Directors, the register of Directors' interests kept by the Company under section 808 of the Companies Act 2006, the Xaar plc 2004 Share Option Plan, the Xaar plc 2007 Share Save Plan and the Xaar plc 2007 Long Term Incentive Plan will be available 15 minutes prior to the commencement of the meeting and will remain open and accessible during the continuance of the meeting to any person attending the meeting.
7. Biographical details of all Directors offering themselves for reappointment are set out on pages 30 and 31 of the annual report and accounts.
8. Shareholders should note that it is possible that, pursuant to requests made by shareholders of the Company under section 527 of the Companies Act 2006, the Company may be required to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the AGM; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006. The Company may not require the shareholders requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act 2006, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the AGM includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.
9. In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that: (i) if a corporate shareholder has appointed the chairman of the meeting as its corporate representative to vote on a poll in accordance with the directions of all of the other corporate representatives for that shareholder at the meeting, then on a poll those corporate representatives will give voting directions to the chairman and the chairman will vote (or withhold a vote) as corporate representative in accordance with those directions; and (ii) if more than one corporate representative for the same corporate shareholder attends the meeting but the corporate shareholder has not appointed the chairman of the meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll and the other corporate representatives will give voting directions to that designated corporate representative. Corporate shareholders are referred to in the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives (www.icsa.org.uk) for further details of this procedure. The guidance includes a sample form of appointment letter if the chairman is being appointed as described in (i) above.
10. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
11. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with CRESTCo's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10) by 9.30am on 12 May 2014. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
12. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST Personal Member, or sponsored member, or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
13. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
14. As at 7.00am on 18 March 2014 (the date of publication of this Notice), the Company's issued share capital comprised 76,096,766 Ordinary shares of 10p each. Each ordinary share carries the right to one vote at a general meeting of the Company, except for the shares held in trust for the Xaar Share Incentive Plan totalling 52,894 shares and, therefore, the total number of voting rights in the Company as 7.00am on 18 March 2014 is 76,043,872.
15. Any member attending the meeting has the right to ask questions. The Company must answer any such question relating to the business being dealt with at the meeting but no such answer need be given if: (a) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information; (b) the answer has already been given on a website in the form of an answer to a question; or (c) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.
16. A copy of this Notice, and other information required by section 311A of the Companies Act 2006, can be found at www.xaar.com.

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