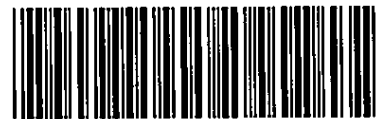


## Xaar Technology Limited

Financial Statements for the year ended 31 December 2006  
together with Directors' report and Auditor's report

Registered number 2469592

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## Xaar Technology Limited Annual Report and Accounts 2006

### Directors' report for the year ended 31 December 2006

The directors present their annual report on the affairs of the company, together with the financial statements and auditor's report for the year ended 31 December 2006

#### Results and dividends

Turnover for the year was £3,845,000 (2005 £2,697,000) and comprises licence fees and royalties, and development fees. The loss for the year after taxation was £320,000 (2005 profit of £1,464,000). The directors do not recommend the payment of a dividend (2005: £nil).

#### Principal activity and business review

The principal activity of the company continues to be the research, development and commercial exploitation of a patented ink jet printing technology.

The company's key financial and other performance indicators during the year were as follows:

	2006 £'000	2005 £'000	Change %
Turnover	3,845	2,697	43%
Gross margin	94%	90%	4%
Research and development expenditure	742	1,175	-37%
Profit before tax	53	525	-90%

Turnover for the year increased by £1,148,000 (43%). This is primarily due to increased income from development fees from other group companies arising because of additional costs in the period for the amortisation of intellectual property. Since the costs have been incurred for the benefit of the business of XaarJet Limited, they have been recharged at an agreed mark-up of 15%.

In addition, as expected, royalty receipts from our licensees continue to increase steadily. Toshiba TEC, Konica Minolta and Seiko Printek are each growing their piezo inkjet businesses, based on Xaar's technology. During the year these licensees won a number of new supply contracts, increasing the volume of heads they produce and, consequently, the royalties payable to Xaar.

Gross margin for the year was higher than the prior year at 94% (2005: 90%), which can be explained by the additional development fee income discussed above.

Research and development expenditure has fallen by 37% compared to the prior year. This is because the focus of the Xaar group of companies during 2006 has been the development of a new manufacturing facility, rather than pure research into our core technology.

Profit before tax has decreased by £472,000 compared to the prior year. This is primarily attributed to the increase in interest payable of £291,000. On 30 April 2006, Xaar Digital Limited issued a loan to Xaar Technology Limited of £5,888,000. This loan bears interest at the 12 month sterling libor rate, plus 2%, which has resulted in interest payable of £293,000 during the year.

#### Principal risks and uncertainties

The company's activities expose it primarily to the financial risks of liquidity risk and credit risk.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The company aims to mitigate liquidity risk by managing cash generation by its operations, applying cash collection targets. The company also manages liquidity risk by funding significant fixed asset purchases by finance leases repayable over a period of three to five years dependent on the individual asset being financed.

## **Xaar Technology Limited Annual Report and Accounts 2006**

### **Directors' report (continued)**

#### **Principal risks and uncertainties (continued)**

Credit risk is the risk that one party to a financial instrument will cause a financial loss for that other party by failing to discharge an obligation. Company policies are aimed at minimising such losses, and require that deferred terms are only granted to customers who demonstrate an appropriate payment history and satisfy credit worthiness procedures.

#### **Research and development**

The majority of the company's employees are involved in research and development and £742,000 (2005 £1,175,000) was spent on research and development in the year.

#### **Market trends and future developments**

In the coming months and years, Xaar's growth will come from our latest technology Platform 2 and Platform 3 printheads. These will significantly broaden the number of end market applications which we address and strengthen our overall competitiveness in the industry. Throughout 2007, research and development projects will continue in order to exploit the opportunities provided by such new markets.

We continue to see industrial inkjet as a key enabling technology in both printing and industrial markets and, as a market leader, we intend to remain at the forefront of that development and growth.

#### **Directors and their interests**

The directors who served throughout the year were as follows:

N A Berry  
I Dinwoodie

Both directors are also directors of Xaar plc. Details of their remuneration and share option arrangements are included in the Remuneration Report in the Report and Accounts of Xaar plc for the year ended 31 December 2006.

The directors who held office at 31 December 2006 had no interest in the issued shares of the company, which are 100% owned by Xaar plc. Details of directors' interests in the shares of the parent company are disclosed in the Report and Accounts of Xaar plc for the year ended 31 December 2006.

#### **Statement of directors' responsibilities**

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 such financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to 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 these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- 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.

**Directors' report (continued)**

**Statement of Directors' responsibilities (continued)**

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

**Directors' liabilities**

The company has granted an indemnity to one or more 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 1985. Such qualifying third party indemnity provision remains in force as at the date of approving the Directors' report.

**Supplier payment policy**

The company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. The number of supplier days outstanding at the year end was 13 days (2005 45 days).

**Auditors**

Ernst & Young LLP were appointed as auditors during the year, and have expressed their willingness to continue in office as auditors.


The company has in place an elective regime to dispense with the need to hold annual general meetings, lay reports and accounts before the shareholders at a general meeting, and the requirement to re-appoint the auditors, Ernst & Young LLP, annually.

**Directors' statement as to disclosure of information to auditors**

The directors who were members of the board at the time of approving the Directors' report are listed on page 3. Having made enquiries of fellow directors and the company's auditors, 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 company's auditors are 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 company's auditors are aware of that information.

On behalf of the Board



I N Dinwoodie  
Director  
19 October 2007

Science Park  
Cambridge  
CB4 0XR  
Registered no 2469592

## Xaar Technology Limited Annual Report and Accounts 2006

### Independent auditor's report to the members of Xaar Technology Limited

We have audited the company's financial statements for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet and the related notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 auditors' 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.

#### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

#### Basis of audit opinion


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

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

#### Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its loss for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements.

  
Ernst & Young LLP  
Registered auditor  
Cambridge

Date 24 October 2007

## Xaar Technology Limited Annual Report and Accounts 2006

### Profit and loss account For the year ended 31 December 2006

	Notes	2006 £'000	As restated 2005 £'000
<b>Turnover</b>	2	<b>3,845</b>	2,697
Cost of sales		(236)	(263)
<b>Gross profit</b>		<b>3,609</b>	2,434
Other operating expenses (net)	3	(3,259)	(1,903)
<b>Operating profit</b>		<b>350</b>	531
Interest payable	4	(297)	(6)
<b>Profit on ordinary activities before taxation</b>	5	<b>53</b>	525
Tax on profit on ordinary activities	7	(373)	939
<b>Retained (loss)/profit for the financial year</b>	15, 16	<b>(320)</b>	1,464

There were no recognised gains or losses except for the loss for the current financial year and the profit for the preceding financial year and therefore no statement of total recognised gains and losses has been provided

All results for the year derive from continuing activities

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

**Xaar Technology Limited Annual Report and Accounts 2006**

**Balance sheet  
As at 31 December 2006**

	Notes	2006 £'000	As restated 2005 £'000
<b>Fixed assets</b>			
Intangible assets	8	5,040	6,300
Tangible assets	9	721	807
		<b>5,761</b>	<b>7,107</b>
<b>Current assets</b>			
Debtors	10	28,113	23,554
Cash at bank and in hand		1	1
		<b>28,114</b>	<b>23,555</b>
<b>Creditors: amounts falling due within one year</b>	11	<b>(26,888)</b>	<b>(23,418)</b>
<b>Net current assets</b>		<b>1,226</b>	<b>137</b>
<b>Total assets less current liabilities</b>		<b>6,961</b>	<b>7,244</b>
<b>Creditors: amounts falling due after more than one year</b>	12	<b>-</b>	<b>(4)</b>
<b>Net assets</b>		<b>6,987</b>	<b>7,240</b>
<b>Capital and reserves</b>			
Called up share capital	14	4,445	4,445
Share premium account	15	1,105	1,105
Share-based payments	15	152	85
Own shares	17	(20)	(20)
Profit and loss account	15	1,305	1,625
<b>Shareholders' funds – all equity</b>	16	<b>6,987</b>	<b>7,240</b>

Signed on behalf of the Board



I N Dinwoodie  
Director

19 October 2007

The accompanying notes are an integral part of this balance sheet

# Xaar Technology Limited Annual Report and Accounts 2006

## Notes to the financial statements

### 1. Accounting policies

#### Basis of accounting

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards. In addition, the directors have received a formal letter of support from the company's parent undertaking, Xaar plc, guaranteeing continued financial support to enable the company to meet its liabilities to creditors as they fall due for the foreseeable future. This is the basis for preparing these financial statements under the going concern assumption.

Group accounts incorporating Xaar Trustee Limited have not been prepared on the basis that the parent company, Xaar plc, prepares consolidated group accounts including this subsidiary company. These financial statements therefore present information about the parent entity only.

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year, with the exception of the accounting treatment of share-based payments. In accordance with FRS 20, the fair value of options and share awards which ultimately vest have been charged to the profit and loss account over the vesting or performance period. For equity-settled transactions, the fair value is determined at the date of the grant using an appropriate pricing model. If an award fails to vest as the result of certain types of performance condition not being satisfied, the charge to the income statement will be adjusted to reflect this. Consequently, additional staff costs of £67,000 (2005 £49,000) and a deferred tax asset of £46,000 (2005 £26,000) have been recognised in the profit and loss account and the balance sheet respectively.

#### Intangible fixed assets

Payments in respect of intellectual property rights are capitalised at cost and amortised on a straight-line basis over their estimated useful lives.

#### Tangible fixed assets

All tangible fixed assets are 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, other than assets in the course of construction, over their estimated useful lives, using the straight-line method, on the following bases:

Leasehold improvements	10 years
Plant and machinery	3 – 5 years
Furniture, fittings and equipment	3 – 5 years
Motor vehicles	3 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.

#### Investments

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



## Xaar Technology Limited Annual Report and Accounts 2006

### Notes to the financial statements (continued)

#### 1. Accounting policies (continued)

##### Foreign currency

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

##### Research and development

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

##### Pension costs

Xaar Technology Limited employees are members of the Xaar plc group's defined contribution pension scheme. Amounts charged in the profit and loss account comprise employer's contributions payable to the company's defined contribution group personal pension scheme in respect of pensionable payroll costs for the accounting year.

##### 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 goods are delivered and title has passed.

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

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.

##### Government grants

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

Government grants relating to property, plant and equipment are treated as deferred income and released to profit or loss over the expected useful lives of the assets concerned.

##### Leases

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

Notes to the financial statements (continued)

1. Accounting policies (continued)

Leases (continued)

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

Taxation

UK corporation 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 tax is provided in full on timing differences, which 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 they 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 are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Cash flow statement

The company has taken advantage of the exemption permitted in paragraph 5(a) of Financial Reporting Standard No. 1 (Revised), not to include a cash flow statement in its financial statements as its ultimate parent company, Xaar plc (of which Xaar Technology Limited is a wholly owned subsidiary), prepares consolidated financial statements which are publicly available.

Share-based payments

The company has applied the requirements of FRS 20 (IFRS 2) *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 as of 1 January 2005.

Xaar plc issues equity-settled share-based payments to certain of the group's 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.

Fair value is measured using the Black-Scholes pricing model. 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.

2. Segment information

Turnover by class of business:

	2006	2005
	£'000	£'000
Development fees	2,304	1,384
Licence fees and royalties	1,541	1,313
	<b>3,845</b>	<b>2,697</b>

## Xaar Technology Limited Annual Report and Accounts 2006

### Notes to the financial statements (continued)

#### 2. Segment information (continued)

##### Turnover by geographical segment

	2006 £'000	2005 £'000
Europe and Middle East	2,303	1,384
Asia	1,467	1,169
Americas	75	144
	<b>3,845</b>	<b>2,697</b>

#### 3. Operating expenses (net)

	2006 £'000	As restated 2005 £'000
Administrative expenses	3,259	1,903

##### Administrative expenses consist of

	2006 £'000	As restated 2005 £'000
Research and development	742	1,175
Other	2,517	728
	<b>3,259</b>	<b>1,903</b>

#### 4. Interest payable and similar charges

	2006 £'000	2005 £'000
Bank interest payable	-	1
Interest payable on loans from group undertakings	293	-
Finance leases and hire purchase contracts	4	5
	<b>297</b>	<b>6</b>

## Xaar Technology Limited Annual Report and Accounts 2006

### Notes to the financial statements (continued)

#### 5. Profit on ordinary activities before taxation

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

	2006 £'000	As restated 2005 £'000
Research and development expenditure	742	1,175
Government grants towards research and development	(10)	(7)
Depreciation		
-on assets owned	286	277
-on assets held under finance leases	20	47
Operating lease rentals in respect of		
-hire of plant and machinery	69	92
-land and buildings	425	312
Profit on disposal of tangible fixed assets	(5)	-
Staff costs (see note 6)	496	575
Auditors' remuneration (see below)	21	155

A more detailed analysis of auditors' remuneration is provided below

	2006 Ernst & Young LLP £'000	2005 Deloitte & Touche LLP £'000
Audit services - statutory audit	21	44
Tax services		
-compliance services	-	24
-advisory services	-	86
	-	110
Other services – employee-related tax advice	-	1
<b>Total auditors' remuneration</b>	<b>21</b>	<b>155</b>

#### 6 Staff costs

Employee costs during the year amounted to

	2006 £'000	As restated 2005 £'000
Wages and salaries	371	445
Social security costs	42	58
Other pension costs	16	23
Share-based payments	67	49
	<b>496</b>	<b>575</b>

# Xaar Technology Limited Annual Report and Accounts 2006

## Notes to the financial statements (continued)

### 6. Staff costs (continued)

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

	2006 No.	2005 No
Research and development	9	7

The directors did not receive any remuneration during the year in respect of their services to the company (2005 nil)

No directors exercised share options in the year (2005 nil)

### 7. Tax on profit on ordinary activities

The tax charge/(credit) comprises

	2006 £'000	As restated 2005 £'000
Current tax charge – foreign tax	126	114
Deferred tax – origination and reversal of timing differences	257	(1,053)
Adjustment in respect of prior years	(10)	-
Total deferred tax charge/(credit)	247	(1,053)
Total tax expense/(credit) for the year	373	(939)

The tax assessed for the year differs from that resulting from applying the standard rate of corporation tax in the UK (30%) The differences are explained below

	2006 £'000	As restated 2005 £'000
Profit on ordinary activities before tax	53	525
Tax at 30% thereon	16	157
Effects of.		
Expenses not deductible for tax purposes	377	(121)
Capital allowances in excess of depreciation	(127)	(62)
Additional 25% deduction for R&D expenditure	(30)	-
Utilisation of tax losses	(197)	-
Share options movement – permanent	(21)	-
Deferred tax movement on share options	20	15
Group relief surrendered not paid for	-	11
Unrelieved foreign taxes expensed	(38)	-
Unrelieved foreign taxes	126	114
Current tax charge for year	126	114

## Xaar Technology Limited Annual Report and Accounts 2006

### Notes to the financial statements (continued)

#### 7. Tax on profit on ordinary activities (continued)

Deferred tax assets have been recognised in full, hence there is no unprovided deferred tax during the current financial year or the preceding year

The following are the major deferred tax assets recognised by the company during the current and previous reporting periods

	Accelerated tax depreciation £'000	Tax losses £'000	Share options £'000	Other temporary difference £'000	Total £'000
At 1 January 2005	-	-	-	-	-
Prior period adjustment – share-based payments	-	-	11	-	11
At 1 January 2005, as restated	-	-	11	-	11
Credit to income	245	783	15	10	1,053
At 1 January 2006	245	783	26	10	1,064
Credit/(charge) to income	53	(320)	20	-	(247)
<b>At 31 December 2006</b>	<b>298</b>	<b>463</b>	<b>46</b>	<b>10</b>	<b>817</b>

At the balance sheet date, the company has no unprovided deferred tax

#### 8. Intangible fixed assets

	Intellectual Property £'000
<b>Cost</b>	
At 1 January 2006	6,300
Additions	-
At 31 December 2006	6,300
<b>Depreciation</b>	
At 1 January 2006	-
Charge for the year	1,260
At 31 December 2006	1,260
<b>Net book value</b>	
At 31 December 2006	5,040
At 31 December 2005	6,300

The amortisation period for this intellectual property is five years on a straight line basis, based on the directors' estimate of its useful economic life

**Xaar Technology Limited Annual Report and Accounts 2006**

**Notes to the financial statements (continued)**

**9. Tangible fixed assets**

	Leasehold improvements £'000	Plant & machinery £'000	Furniture, fittings & equipment £'000	Motor vehicles £'000	Assets in the course of construction £'000	Total £'000
<b>Cost</b>						
At 1 January 2006	969	4,473	1,045	5	65	6,557
Additions	-	3	89	-	128	220
Disposals	-	(100)	-	-	-	(100)
At 31 December 2006	969	4,376	1,134	5	193	6,677
<b>Depreciation</b>						
At 1 January 2006	666	4,271	808	5	-	5,750
Charge for the year	98	86	122	-	-	306
Disposals	-	(100)	-	-	-	(100)
At 31 December 2006	764	4,257	930	5	-	5,956
<b>Net book value</b>						
At 31 December 2006	205	119	204	-	193	721
At 31 December 2005	303	202	237	-	65	807
Leased assets included in the above						
<b>Net book value</b>						
At 31 December 2006	-	10	1	-	-	11
At 31 December 2005	-	27	4	-	-	31

**10. Debtors**

	2006 £'000	As restated 2005 £'000
<b>Amounts falling due within one year:</b>		
Trade debtors	-	1
Amounts owed by group undertakings	26,608	21,749
Amounts owed by parent undertaking	140	141
VAT	22	51
Prepayments and accrued income	526	548
	27,296	22,490
<b>Amounts falling due after more than one year:</b>		
Deferred tax asset	817	1,064
	28,113	23,554

**Xaar Technology Limited Annual Report and Accounts 2006**

**Notes to the financial statements (continued)**

**11. Creditors: amounts falling due within one year**

	2006 £'000	2005 £'000
Obligations under finance leases and hire purchase contracts	5	21
Trade creditors	115	414
Amounts owed to parent undertaking	20,119	16,210
Amounts owed to group undertakings	6,180	6,300
Taxation and social security	163	120
Amount due to pension scheme	35	32
Accruals	271	321
	<b>26,888</b>	<b>23,418</b>

**12. Creditors: amounts falling due after more than one year**

	2006 £'000	2005 £'000
Obligations under finance leases and hire purchase contracts due between 2 to 5 years	-	4

**13. Obligations under finance leases**

	Minimum lease payments	
	2006 £'000	2005 £'000
Amounts payable under finance leases		
Within one year	5	21
In the second to fifth years inclusive	-	4
	5	25
Less amount due for settlement within twelve months (shown under current liabilities)	(5)	(21)
Amount due for settlement after twelve months	-	4

**14. Called-up share capital**

	2006 £'000	2005 £'000
<i>Authorised</i>		
5,132,072 ordinary shares of £1 each	5,132	5,132
<i>Allotted, called-up and fully paid</i>		
4,445,322 ordinary shares of £1 each	4,445	4,445



## Xaar Technology Limited Annual Report and Accounts 2006

### Notes to the financial statements (continued)

#### 15. Statement of movement on reserves

The movement on reserves for the year and the previous year is as follows

	Own shares £'000	Share premium account £'000	Share- based payments £'000	Profit and loss account £'000	Total £'000
At 1 January 2005	(20)	1,105	-	186	1,271
Transfer to share-based payment reserve	-	-	36	(36)	-
Deferred tax credit on share-based payments	-	-	-	11	11
At 1 January 2005, as restated	(20)	1,105	36	161	1,282
Prior year adjustment – share-based payments	-	-	49	-	49
Net profit for the financial year	-	-	-	1,464	1,464
At 1 January 2006, as restated	(20)	1,105	85	1,625	2,795
Share-based payments	-	-	67	-	67
Retained loss for the financial year	-	-	-	(320)	(320)
<b>At 31 December 2006</b>	<b>(20)</b>	<b>1,105</b>	<b>152</b>	<b>1,305</b>	<b>2,542</b>

The share premium account is not distributable

The net profit for the prior year as originally published was £1,498,000. The movement of £34,000 is due to the share-based payments charge of £49,000, offset by an increase in the deferred tax asset of £15,000.

#### 16. Reconciliation of movements in shareholders' funds

	2006 £'000	As restated 2005 £'000
(Loss)/profit for the financial year	(320)	1,464
Share-based payments	67	49
Net (reduction in)/addition to shareholders' funds	(253)	1,513
Opening shareholders' funds	7,240	5,727
Closing shareholders' funds	6,987	7,240

#### 17. Investment in own shares

An Employee Benefit Trust was established in 1995 to hold shares for the benefit of the employees of the company. Xaar Trustee Limited was formed during 1995 to act as trustee to the Trust. At 31 December 2006 and 2005 there were 91,250 10p ordinary shares in Xaar plc held in trust by Xaar Trustee Limited at a cost of £20,000. In accordance with UITF 38, this amount was transferred to reserves in 2005. The aggregate market value of these shares at 31 December 2006 was £219,228 (2005 £245,006). There has been no movement in the number of shares held in trust by Xaar Trustee Ltd during the year.

Notes to the financial statements (continued)

18. Investments

	2006 £	2005 £
Investment in subsidiary	2	2

The entire issued and paid up ordinary share capital of Xaar Trustee Limited is owned by Xaar Technology Limited (2 ordinary shares of £1 each)

19. Share-based payments

*Equity-settled share option scheme*

The parent company, Xaar plc'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 vesting period is three years. 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, the options expire. Save as permitted in the share option scheme rules options lapse on an employee leaving the group.

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

	2006		2005	
	Number of share options	Weighted average exercise price (£)	Number of share options	Weighted average exercise price (£)
Outstanding at beginning of period	426,079	1.17	418,568	0.69
Adjustment to options outstanding at beginning of period*	(24,717)	2.73	-	-
Granted during the period	74,482	2.08	115,552	2.51
Lapsed during the period	(16,135)	1.49	(13,287)	0.75
Exercised during the period	(80,472)	0.44	(94,754)	0.75
Outstanding at the end of the period	379,237	1.39	426,079	1.17
Exercisable at the end of the period	117,533	0.63	77,506	0.76

\* This adjustment corrects a misstatement in the number of options reported as granted in 2005

The weighted average share price at the date of exercise for share options exercised during the period was £2.45. The options outstanding at 31 December 2006 had a weighted average remaining contractual life of seven years. In 2006, options were granted on 3 April and 9 October. The aggregate of the estimated fair values of the options granted on those dates is £0.8m. In 2005, options were granted on 15 March, 13 April and 15 September. The aggregate of the estimated fair values of the options granted on those dates is £1.1m.

An option granted under the Xaar plc 2004 share option plan 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 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.

Notes to the financial statements (continued)

19. Share-based payments (continued)

*Equity-settled share option scheme (continued)*

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.

The inputs to the Black-Scholes model are as follows

	2006	2005
Weighted average share price	£2.07	£2.53
Weighted average exercise price	£2.08	£2.51
Expected volatility	40%	60%
Expected life	6.5 years	6.5 years
Risk free rate	4.8%	4.8%
Expected dividends	0.1%	-

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.

The company recognised total expenses of £67,000 (2005: £49,000) related to equity-settled share-based payment transactions in the year.

20. Guarantees and other financial commitments

a) Lease commitments

The company has entered into non-cancellable leases in respect of fixtures and fittings and motor vehicles, the payments for which extend over a period of up to 3 years. The total rental for the year was £69,000 (2005: £92,000).

In addition, the company leases land and buildings. The rental for the year was £425,000 (2005: £312,000).

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

	Land & buildings		Fixtures & fittings		Motor vehicles	
	2006	2005	2006	2005	2006	2005
	£'000	£'000	£'000	£'000	£'000	£'000
Within 1 year	22	21	43	11	1	-
In the second to fifth years inclusive	-	-	-	-	26	32
After 5 years	418	418	-	-	-	-
	440	439	43	11	27	32

The operating leases in respect of fixtures & fittings and motor vehicles extend over a period of up to three years.

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### **Notes to the financial statements (continued)**

#### **20. Guarantees and other financial commitments (continued)**

##### **b) Capital commitments**

At the end of the year, the company had capital commitments contracted for but not provided of £8,000 (2005 £39,000)

#### **21. Related party disclosures**

As the company is a 100% owned subsidiary of Xaar plc, whose consolidated accounts are publicly available, it is not required to disclose transactions with other group undertakings that would otherwise be required under Financial Reporting Standard No 8 'Related party disclosures'

#### **22. Parent company and controlling party**

At the year-end the company was a fully owned subsidiary undertaking of Xaar plc registered in England and Wales. The directors consider Xaar plc to be the ultimate controlling party of the company.

The largest and smallest group in which the results of the company are consolidated is that headed by Xaar plc, whose principal place of business is Science Park, Cambridge CB4 0XR. The consolidated financial statements of the group are available to the public and may be obtained from the above address.