

Five Year Financial Review

CONSOLIDATED STATEMENT OF OPERATIONS DATA:

In thousands, except per-share amounts

YEAR ENDED DECEMBER 31	1998	1997 (1)	1996 (1)	1995 (1)	1994
Net sales	\$ 335,983	\$ 297,100	\$ 252,487	\$ 200,319	\$ 136,379
Cost of sales	180,173	153,392	135,474	106,365	71,333
Gross profit	155,810	143,708	117,013	93,954	65,046
Total operating expenses	94,174 (2)	72,446	62,880 (4)	43,328	29,368
Income from operations	61,636 (2)	71,262	54,133 (4)	50,626	35,678
Income from continuing operations before provision for income taxes	65,021 (2)	85,225 (3)	60,703 (4)	56,185	38,095
Income from continuing operations	40,069 (2)	54,447 (3)	37,952 (4)	36,693	24,696
Earnings per share from continuing operations					
Basic	\$ 1.30 (2)	\$ 1.76(3)	\$ 1.24 (4)	\$ 1.22	\$.85 (5)
Diluted	\$ 1.29 (2)	\$ 1.74(3)	\$ 1.21 (4)	\$ 1.19	\$.83 (5)
Weighted average number of shares outstanding					
Basic	30,919	30,897	30,696	30,128	29,011 (5)
Diluted	31,176	31,380	31,269	30,780	29,813 (5)

CONSOLIDATED BALANCE SHEET DATA:

In thousands

DECEMBER 31	1998	1997	1996	1995	1994
Cash and cash equivalents and investments and marketable securities	\$ 162,668	\$ 139,320	\$ 103,777	\$ 88,139	\$ 60,053
Working capital	229,688	209,862	164,678	131,369	86,704
Total assets	310,002	270,447	218,631	176,695	114,537
Long-term obligations	36	314	3,137	2,928	236
Shareholders' equity	270,884	236,220	184,007	144,391	93,812

(1) Revised to reflect the discontinuance of operations of Zebra Technologies VTI, which was acquired by the Company in July 1995.

(2) Includes a pretax charge for merger costs of \$8,080 relating to the merger with Eltron International, Inc.

(3) Includes a one-time pretax gain of \$5,458 from the sale of Zebra's investment in Norand Corporation common stock.

(4) Reflects a pretax charge for acquired in-process technology of \$1,117 relating to the Company's acquisition of Fenestra Computer Services and \$2,500 relating to the Company's acquisition of Privilege, S.A.

(5) Adjusted to reflect a two-for-one stock split on December 28, 1995.

Management's Discussion and Analysis of Financial Condition and Results of Operations

GENERAL

On October 28, 1998, the Company merged with Eltron International, Inc. This transaction has been accounted for as a pooling of interests for financial reporting purposes. All financial statements for prior periods presented have been restated to give effect to the combination.

In the fourth quarter of 1998, the Company recorded one-time charges totaling \$13,161,000 related to the merger with Eltron. Of this amount, \$8,080,000 is reported separately as Merger Costs and consists of fees for accountants, attorneys, consultants, and investment bankers, as well as provisions for facilities consolidation and severance costs. The balance of \$5,081,000 relates to adjustments to bring the former Eltron operations into conformance with Zebra's accounting policies and to eliminate certain duplicate assets. These adjustments, which are reported within Cost of Goods Sold and Operating Expenses as described below, include increases to inventory and bad debt reserves and the expensing of certain duplicate fixed assets.

COMPARISON OF YEARS ENDED DECEMBER 31, 1998 AND 1997

Net sales increased 13.1% in 1998 to \$335,983,000 from \$297,100,000 in 1997. Unit growth in hardware (printers and replacement parts) principally drove sales growth. Product mix changes lowered the average unit price for printers, since volume in lower-priced models increased faster than higher-priced models. Price reductions on some printer models also affected average unit prices, although management does not consider these reductions to be a material contributor to the overall decline in average prices. Hardware sales increased 18.5% to 79.4% of net sales, and supplies sales increased 5.4% to 18.6% of net sales. The remaining 2.0% of net sales consisted of service and software revenue.

International sales increased 8.5% to \$136,128,000 from \$125,411,000 and accounted for 40.5% of net sales in 1998, compared with 42.2% of net sales in 1997. The decrease in the percentage of international sales is principally due to higher sales growth to North American customers combined with a decline in sales to the Asia-Pacific region. Notwithstanding this decrease, management believes that international markets for bar code-related products and services will grow faster than domestic markets because of lower levels of market penetration by the technology. To support its long-term international business expansion strategy, the Company opened a new sales office in Japan in 1998.

Gross profit increased 8.4% to \$155,810,000 from \$143,708,000 for 1997. As a percentage of net sales, gross profit decreased 2.0 percentage points to 46.4% from 48.4%. Gross profit for 1998 was affected by \$3,485,000 in one-time adjustments related to the Eltron merger. Excluding this one-time charge, gross profit for 1998 would have been \$159,295,000, or 47.4% of net sales. The decline in gross profit margin was also due to an unfavorable shift in product mix toward lower margin printers.

Selling and marketing expenses of \$36,052,000 increased 9.2% from \$33,017,000. As a percentage of net sales, selling and marketing expenses decreased to 10.7% from 11.1%. For 1998, selling and marketing expenses include \$242,000 in one-time charges related to the Eltron merger. Excluding these one-time charges, selling and marketing expenses for 1998 would have been \$35,810,000, or 10.7% of net sales. During 1998, the Company increased staff levels to support anticipated higher levels of business. Higher personnel-related expenses and depreciation were partially offset by lower advertising and trade show expenses.

Research and development expenses for 1998 totaled \$21,428,000, or 6.4% of net sales, compared with \$17,911,000, or 6.0% of net sales, for 1997. Research and development expenses for 1998 include \$175,000 in one-time charges related to the Eltron merger. Excluding these one-time charges, research and development expenses for 1998 would have been \$21,253,000, or 6.3% of net sales. Higher personnel-related expenses and prototype work related to new product development were primarily responsible for the increase.

General and administrative expenses increased by 33.0% to \$28,614,000 from \$21,518,000. As a percentage of net sales, general and administrative expenses increased to 8.5% from 7.2%. Excluding \$1,178,000 in one-time charges related to the Eltron merger, 1998 general and administrative expenses were \$27,436,000, or 8.2% of net sales. In 1998, the Company incurred higher personnel costs related to increased staffing levels. Depreciation and other expenses also increased, as Zebra's Baan ERP system became active during the second quarter of 1998.

In 1998, the Company incurred \$8,080,000 in costs related to the Eltron merger. These merger costs include accounting, legal, investment banking, and consulting fees, as well as provisions for facilities consolidation and severance.

Other income decreased to \$3,358,000 from \$13,963,000, including investment income of \$4,005,000 compared with \$13,520,000. During the second half of 1998, net investment income declined because of financial market volatility. In addition, investment income for 1997 includes a one-time pretax investment gain of \$5,458,000, which was recognized in the first quarter of 1997. This one-time gain resulted from the sale by the Company of 350,000 shares of Norand Corporation common stock. Excluding this gain, investment income for 1997 would have been \$8,062,000. During the fourth quarter of 1998, the Company took steps to reduce its investment portfolio's exposure to market volatility.

Income from continuing operations before income taxes was \$65,021,000, compared with \$85,225,000, a decrease of \$20,204,000, or 23.7%. Excluding the \$13,161,000 in merger-related charges in 1998 and the one-time investment gain recognized in the first quarter of 1997, income from continuing operations before taxes declined 2.0% to \$78,182,000 in 1998 from \$79,767,000 in 1997.

The effective income tax rate for 1998 was 38.4%, compared with 36.1% for 1997. The provision for income taxes for 1998 includes the effect of \$2,875,000 in certain merger-related costs, which are not deductible for income tax purposes. Excluding these effects, the Company's effective tax rate for 1998 would have been 36.8%.

Income from continuing operations for 1998 was \$40,069,000, or \$1.29 per diluted share. For 1997, income from continuing operations was \$54,447,000, or \$1.74 per diluted share.

COMPARISON OF YEARS ENDED DECEMBER 31, 1997 AND 1996

Net sales increased 17.7% to \$297,100,000 from \$252,487,000. The sales increase is principally attributable to unit growth in hardware (printers and replacement parts). The average unit price for printers declined slightly, because of product mix changes since volume in lower-priced models grew faster than volume in higher-priced models, although selective price decreases were made in portions of the Company's product line. Hardware sales increased 25.6% to 75.8% of net sales, and supplies sales increased 6.9% to 20.0% of net sales. The remaining 4.2% of net sales consisted of service and software revenue.

International sales accounted for 42.2% of net sales in 1997, compared with 41.3% of net sales in 1996. The Company opened sales offices in France,

Germany and Singapore (2 facilities) in 1997. In 1996, the Company opened a sales office in Miami, Florida, to serve Central and South American markets.

Gross profit was \$143,708,000, up 22.8% from the gross profit of \$117,013,000 for 1996. As a percentage of net sales, gross profit increased 2.1 percentage points to 48.4% from 46.3%. The increase in gross profit margin was due to a decrease in printer component costs, offset in part by a \$544,000 provision for certain excess component inventories related to the phase-out of a printer program with a key customer.

Selling and marketing expenses of \$33,017,000 increased 16.0% from \$28,461,000. As a percentage of net sales, selling and marketing expenses decreased to 11.1% from 11.3%. Growth in selling and marketing expenses occurred because of higher expenses related to the opening of new international and domestic sales offices, the opening of a new distribution facility in the United Kingdom, and expansion of the Company's card printer facility in France. Selling and marketing expenses also increased as a result of advertising and promotional expenses related to the introduction of new products.

Research and development expenses increased 18.2% to \$17,911,000 from \$15,159,000. This increase is primarily related to higher staffing levels to support more aggressive new product development efforts. As a percentage of sales, research and development expenses were unchanged at 6.0%.

General and administrative expenses increased by 50.5% to \$21,518,000 from \$14,299,000. The Company incurred higher expenses for increased staffing levels, greater use of professional services, and certain project costs related to implementation of the Company's enterprise-wide software system. As a percentage of net sales, general and administrative expenses increased to 7.2% from 5.7%.

In 1996, the Company incurred charges for acquired in-process technology of \$3,617,000, related to the acquisition of Fenestra Computer Services and Privilege, S.A. In addition, \$1,344,000 is reflected in merger costs for legal and other costs associated with business combinations, either attempted or completed. No such costs were recorded in 1997.

Other income increased 112.5% to \$13,963,000 from \$6,570,000. This growth was principally due to a \$7,137,000 increase in investment income, which

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

includes a one-time gain of \$5,458,000 recorded in the first quarter of 1997 from the sale by the Company of 350,000 shares of Norand Corporation common stock. Excluding this gain, investment income would have increased \$1,679,000, or 26.3%, as a result of realized and unrealized gains on the Company's investment portfolio.

Income from continuing operations before income taxes was \$85,225,000, compared with \$60,703,000, an increase of \$24,522,000, or 40.4%. Excluding the previously discussed one-time investment gain recognized in the first quarter of 1997, income from continuing operations before taxes increased 31.4%.

The effective income tax rate for 1997 was 36.1%, compared with 37.5% for 1996. The provision for income taxes for 1996 includes the effect of the write-off of certain acquired in-process technology and acquisition costs, which were not deductible for income tax purposes, the utilization of certain tax credits, and the reduction of the deferred tax valuation allowance. Excluding these effects, the Company's effective tax rate for 1996 would have been 35.4%.

Income from continuing operations for 1997 was \$54,447,000, or \$1.76 per basic share and \$1.74 per diluted share. For 1996, income from continuing operations was \$37,952,000, or \$1.24 per basic share and \$1.21 per diluted share.

DISCONTINUED OPERATIONS

During 1997, the Company decided to discontinue the operations of its Zebra Technologies VTI subsidiary (Zebra VTI), which developed bar code label design software targeted at the small business market and distributed through PC distributors and catalogs. A one-time charge of \$2,363,000, net of applicable tax benefit, was recorded in the second quarter of 1997 to cover expected product returns, provisions for slow-moving and obsolete inventory, estimated contingent liabilities, and the write-off of remaining goodwill and other intangible assets. Remaining business records and assets were transferred to other portions of the Company. Financial results for prior quarters were revised to reflect the discontinued operations. The Company originally acquired Zebra VTI in July 1995.

LIQUIDITY AND CAPITAL RESOURCES

Internally generated funds from operations are the primary source of liquidity for the Company. As of December 31, 1998, the Company had \$162,668,000 in cash and marketable securities, compared with \$139,320,000 at the end of 1997.

The Company has a \$6,000,000 unsecured line of credit plus an additional \$4,000,000 unsecured revocable line of credit with its bank. These credit facilities are priced at either the prime rate or 100 basis points over the London Interbank Offered Rate (LIBOR), at the Company's discretion. As of December 31, 1998, the Company had borrowings of \$184,700 outstanding under its lines of credit. The Company also has a revolving credit facility that allows the Company to borrow up to \$10,000,000 on an unsecured basis. Borrowings under the revolving credit facility bear interest at the bank's prime rate. The Company did not use this revolving credit facility during 1998.

Capital expenditures in 1998 were \$25,615,000, compared with \$10,241,000 in 1997 and \$11,274,000 in 1996. The increase in capital expenditures in 1998 includes purchases of new manufacturing and distribution facilities in Camarillo, California (purchased in conjunction with the Eltron merger), and Preston, the United Kingdom, as well as expenditures on computer hardware and software, including the Company's new enterprise-wide resource planning (ERP) system. Management believes that existing capital resources and funds generated from operations are sufficient to finance anticipated capital requirements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities*. This pronouncement will require the Company to recognize derivatives on its balance sheet at fair value. Changes in the fair values of derivatives that qualify as cash flow hedges will be recognized in other comprehensive income until the hedged item is recognized in earnings. The Company expects that this new standard will not have a significant effect on its results of operations. SFAS 133 is effective for fiscal years beginning after June 15, 1999.

YEAR 2000 CONSIDERATIONS

Internal Systems. Management believes that substantially all of Zebra's critical internal computer systems and technical infrastructure is presently Year 2000 (Y2K) compliant and that those systems not presently compliant will be brought into compliance in sufficient time to avoid adverse business consequences as the result of the Year 2000. Among the systems not compliant as of December 31, 1998, are the Company's internal payroll system utilized at its Vernon Hills headquarters facility, and the manufacturing control software used in its Preston label

conversion facility in the U.K. Both systems are scheduled for replacement or upgrade during 1999 to bring them into compliance by the end of the third quarter of 1999. A variety of sub-systems were also non-compliant as of December 31, 1998. These typically require the installation of a software upgrade or patch and do not, in management's opinion, present a serious obstacle to achieving Y2K compliance by year-end.

Products. The Company has reviewed its entire product line for Year 2000 compliance issues and has identified those products that will be affected. In general, Year 2000 issues do not affect the company's printer products because they contain no internal clock or timing mechanism. The Company's current software products are all Y2K compliant, although in some cases previous versions were not. In addition, the Company's PC-470 printer controller contains a real-time clock that must be reset to function properly after January 1, 2000. In all cases where products are not Y2K compliant, customers have been notified via letter or postings on the Company's web site about any corrective action that is needed, including, where appropriate, a requirement to upgrade certain software products.

Suppliers. The Company surveyed each of its significant suppliers to determine their ability to provide necessary products and services that are critical to business continuation through Y2K. To date, 125 suppliers deemed critical to the business have been surveyed and 116 have affirmed positively that they would be Y2K compliant and that there would be no impact on their ability to supply the Company due to Y2K problems. The Company is pursuing responses from the remaining nine suppliers.

Despite these assurances of compliance, the Company does not warrant the performance of its suppliers. The failure by one or more significant suppliers to achieve compliance could have a material adverse effect on the Company. The Company has not undertaken to quantify the effect of such possible non-compliance or to determine the likely worst-case scenario or to develop contingency plans to deal with such a scenario.

Management estimates that it will have incurred approximately \$400,000 of costs to ensure Y2K compliance by December 31, 1999. This includes \$200,000 of direct expenditures to upgrade its systems and products and \$200,000 of management and internal technical support to upgrade systems and ensure the status of compliance within the Company's supplier base. This estimate does not

include the cost of new systems or system upgrades that were made for reasons other than Y2K compliance but included Y2K compliance as part of the upgrade package. Specifically excluded from the cost of Y2K compliance are the cost of the Company's recent conversion to the Baan ERP system and the cost of its new payroll/human resources system, both of which were made for reasons other than Y2K compliance.

SIGNIFICANT CUSTOMERS

For the year ended December 31, 1998, sales to United Parcel Service (UPS), one of the Company's direct customers, accounted for 10.3% of the Company's net sales.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest Rate Risk. The Company is exposed to the impact of changes in interest rates due to its large investment portfolio. As stated in the Company's written investment policy, the Company's investment portfolio is viewed as a strategic resource that will be managed to achieve above market rates of return in exchange for accepting a prudent amount of incremental risk, which includes the risk of interest rate movements. Risk tolerance is constrained by an overriding objective to preserve capital across each quarterly reporting cycle.

The Company mitigates interest rate risk with an investment policy that requires the use of outside professional investment managers, investment liquidity, broad diversification across investment strategies, and limits on the types of investment assets that may be used. Moreover, the policy requires strict due diligence of each manager both before employment and on an on-going basis.

Foreign Exchange Risk. The Company conducts business in more than 90 countries throughout the world and, therefore, can be exposed to movements in foreign exchange rates. Currency exposures are related only to the U.S. dollar/U.K. pound sterling exchange rate arising from invoicing European customers in pounds sterling from the Company's U.K. office and to the U.S. dollar/Japanese yen exchange rate arising from purchases of some thermal transfer ribbons denominated in yen. There is no foreign exchange risk associated with the Company's investment portfolio.

The Company manages its foreign exchange exposure through a policy of selective hedging. This policy involves selling forward up to 180 days, projected remittances in pounds sterling from the Company's U.K. subsidiary. The Company also

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purchases a limited number of yen contracts to hedge the cost of yen-denominated invoices from certain suppliers. This policy mitigates, but does not eliminate, the impact of exchange movements on the value of future cash flows. Thus, adverse movements in either the pound or the yen in relation to the dollar can directly impact the Company's financial results. All foreign exchange contracts are executed by the corporate treasury department only with major financial institutions. Under no circumstances does the Company enter into any type of foreign exchange contract for trading or speculative purposes.

Equity Price Risk. The Company does not generally invest in marketable equity securities, except as part of its acquisition strategy, although one of its investment managers utilizes a market neutral strategy that involves offsetting long-short equity positions. The Company held no direct equity positions as of December 31, 1998.

The Company utilizes a "Value-at-Risk" (VaR) model to determine the maximum potential one-day loss in the fair value of its interest rate, foreign exchange and equity price sensitive instruments.

The following table sets forth the impact of a 1% movement in interest rates on the value of the Company's investment portfolio as of December 31, 1998. Similarly, the impact of a 1% change in the value of all equity positions held by the Company's investment managers is tabulated. The impact of a 1% movement in the dollar/pound and dollar/yen rates is measured as if the Company did NOT engage in the selective hedging practices described above and is based on the actual yen obligations of the Company as of December 31, 1998, and the present value of the projected average monthly remittances from the Company's U.K. subsidiary for the first quarter of 1999.

Interest rate sensitive instruments	\$ 811,300
Foreign exchange	
Dollar/pound	\$ 17,500
Dollar/yen	\$ 12,800
Equity price sensitive instruments	\$ 48,400

SAFE HARBOR

Forward-looking statements contained in this filing are subject to the safe harbor created by the Private Securities Reform Act of 1995 and are highly dependent upon a variety of important factors which could cause actual results to differ materially from those reflected in such forward looking statements. These factors include market acceptance of the Company's products and competitors' product offerings. They also include the success and speed of the Company's integration with Eltron International, as well as the effect of market conditions in the Asia-Pacific region on the Company's financial results. Profits will be affected by the Company's ability to control manufacturing and operating costs. Due to the Company's large investment portfolio, interest rate and financial market conditions will also have an impact on results. Foreign exchange rates will have an effect on financial results because of the large percentage of the Company's international sales. When used in this document and documents referenced, the words "anticipate," "believe," "estimate," and "expect" and similar expressions as they relate to the Company or its management are intended to identify such forward-looking statements. Readers of this document are referred to prior filings with the Securities and Exchange Commission, including Zebra's joint proxy statement/prospectus dated September 21, 1998, particularly the "Risk Factors" section, for further discussions of issues that could affect the Company's future results.

Consolidated Balance Sheets

(Amounts in thousands, except share and per share data)

	December 31, 1998	December 31, 1997
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,391	\$ 10,925
Investments and marketable securities	151,277	128,395
Accounts receivable, net of allowance of \$2,156 in 1998, \$2,130 in 1997	57,654	51,608
Inventories	39,684	43,860
Deferred income taxes	5,137	6,111
Prepaid expenses	1,328	1,678
TOTAL CURRENT ASSETS	266,471	242,577
Property and equipment at cost, less accumulated depreciation and amortization	38,850	23,138
Other assets	4,681	4,732
TOTAL ASSETS	\$ 310,002	\$ 270,447
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 20,565	\$ 17,069
Accrued liabilities	11,498	10,754
Short-term note payable	183	136
Current portion of obligation under capital lease with related party	51	65
Income taxes payable	4,486	4,691
TOTAL CURRENT LIABILITIES	36,783	32,715
Obligation under capital lease with related party, less current portion	—	51
Long-term liability	36	263
Deferred income taxes	1,932	911
Other	367	287
TOTAL LIABILITIES	39,118	34,227
Shareholders' equity:		
Preferred stock, \$.01 par value, 10,000,000 shares authorized, none outstanding	—	—
Class A Common Stock, \$.01 par value; 50,000,000 shares authorized, 22,635,661 and 19,413,933 shares issued and outstanding in 1998 and 1997, respectively	227	194
Class B Common Stock, \$.01 par value; 28,358,189 shares authorized, 8,619,919 and 11,600,937 shares issued and outstanding in 1998 and 1997, respectively	86	115
Additional paid-in capital	49,850	55,918
Retained earnings	219,772	179,703
Accumulated other comprehensive income	949	290
TOTAL SHAREHOLDERS' EQUITY	270,884	236,220
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 310,002	\$ 270,447

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings

(Amounts in thousands, except per share data)

YEAR ENDED	December 31, 1998	December 31, 1997	December 31, 1996
Net sales	\$ 335,983	\$ 297,100	\$ 252,487
Cost of sales	180,173	153,392	135,474
GROSS PROFIT	155,810	143,708	117,013
Operating expenses:			
Selling and marketing	36,052	33,017	28,461
Research and development	21,428	17,911	15,159
General and administrative	28,614	21,518	14,299
Merger costs	8,080	—	1,344
Acquired in-process technology	—	—	3,617
TOTAL OPERATING EXPENSES	94,174	72,446	62,880
OPERATING INCOME	61,636	71,262	54,133
Other income (expense)			
Investment income	4,005	13,520	6,383
Interest expense	(425)	(86)	(116)
Other, net	(195)	529	303
TOTAL OTHER INCOME	3,385	13,963	6,570
Income from continuing operations before income taxes	65,021	85,225	60,703
Income taxes	24,952	30,778	22,751
INCOME FROM CONTINUING OPERATIONS	40,069	54,447	37,952
Discontinued operations :			
Loss from discontinued operation (less applicable income tax benefit of \$372 and \$815 in 1997 and 1996)	—	(1,692)	(1,938)
Loss on disposal of discontinued operations, including provision for operating losses during phase-out period (less applicable income tax benefit of \$615 in 1997)	—	(963)	—
NET INCOME	\$ 40,069	\$ 51,792	\$ 36,014
Basic earnings per share from continuing operations	\$ 1.30	\$ 1.76	\$ 1.24
Diluted earnings per share from continuing operations	\$ 1.29	\$ 1.74	\$ 1.21
Basic earnings per share	\$ 1.30	\$ 1.68	\$ 1.17
Diluted earnings per share	\$ 1.29	\$ 1.65	\$ 1.15
Basic weighted average shares outstanding	30,919	30,897	30,696
Diluted weighted average and equivalent shares outstanding	31,176	31,380	31,269

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income

(Amounts in thousands)

YEAR ENDED	December 31, 1998	December 31, 1997	December 31, 1996
Net income	\$ 40,069	\$ 51,792	\$ 36,014
Other comprehensive income (loss):			
Foreign currency translation adjustment	659	(946)	1,474
Unrealized holding gains (losses) on investments:			
Net change in unrealized holding gains for the period, net of income tax expense of \$3 and \$625 in 1997 and 1996.	—	6	1,160
COMPREHENSIVE INCOME	\$ 40,728	\$ 50,852	\$ 38,648

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(Amounts in thousands)

	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income		Total
					Unrealized Holding Loss On Investments	Cumulative Translation Adjustment	
BALANCE AT DECEMBER 31, 1995	\$ 169	\$ 137	\$ 53,571	\$ 91,917	\$ (1,166)	\$ (238)	\$ 144,390
Adjustment to retained earnings as a result of business combination	—	—	—	(20)	—	—	(20)
Issuance of 56,815 shares of Class A Common Stock	—	—	742	—	—	—	742
Issuance of 152,403 shares of Class B Common Stock	—	1	446	—	—	—	447
Conversion of 2,658 shares of Class B Common Stock to 2,658 shares of Class A Common Stock	—	—	—	—	—	—	—
Cancellation of 20,575 shares of Class B Common Stock in connection with RJS merger	—	—	(776)	—	—	—	(776)
Tax benefit resulting from exercise of options	—	—	576	—	—	—	576
Net income	—	—	—	36,014	—	—	36,014
Foreign currency translation adjustment	—	—	—	—	—	1,474	1,474
Unrealized holding gain on investments	—	—	—	—	1,160	—	1,160
BALANCE AT DECEMBER 31, 1996	169	138	54,559	127,911	(6)	1,236	184,007
Issuance of 64,165 shares of Class A Common Stock	1	—	970	—	—	—	971
Issuance of 144,978 shares of Class B Common Stock	—	1	1,011	—	—	—	1,012
Conversion of 2,424,795 shares of Class B Common Stock to 2,424,795 shares of Class A Common Stock	24	(24)	—	—	—	—	—
Settlement of litigation-Zebra Technologies VTI	—	—	(1,372)	—	—	—	(1,372)
Cancellation of 6,715 shares of Class B Common Stock in connection with RJS merger	—	—	(253)	—	—	—	(253)
Tax benefit resulting from exercise of options	—	—	1,003	—	—	—	1,003
Net income	—	—	—	51,792	—	—	51,792
Foreign currency translation adjustment	—	—	—	—	—	(946)	(946)
Unrealized holding gain on investments	—	—	—	—	6	—	6
BALANCE AT DECEMBER 31, 1997	194	115	55,918	179,703	—	290	236,220
Issuance of 55,578 shares of Class A Common Stock	1	—	1,181	—	—	—	1,182
Issuance of 229,290 shares of Class B Common Stock	—	3	566	—	—	—	569
Conversion of 3,187,641 shares of Class B Common Stock to 3,187,641 shares of Class A Common Stock	32	(32)	—	—	—	—	—
Elimination of intercorporate investments in Eltron	—	—	(8,092)	—	—	—	(8,092)
Tax benefit resulting from exercise of options	—	—	277	—	—	—	277
Net income	—	—	—	40,069	—	—	40,069
Foreign currency translation adjustment	—	—	—	—	—	659	659
BALANCE AT DECEMBER 31, 1998	\$ 227	\$ 86	\$ 49,850	\$ 219,772	\$ —	\$ 949	\$ 270,884

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Amounts in thousands)

YEAR ENDED	December 31, 1998	December 31, 1997	December 31, 1996
Cash flows from operating activities:			
Net income	\$ 40,069	\$ 51,792	\$ 36,014
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	10,248	7,002	5,515
Acquired in-process technology	—	—	3,617
Decrease (increase) in market value of investments & marketable securities	1,085	(5,973)	(2,483)
Deferred income taxes	1,995	(3,761)	103
Discontinued operations	—	(3,371)	—
Changes in assets and liabilities, net of businesses acquired:			
Accounts receivable, net	(6,046)	(3,645)	(12,713)
Inventories	4,176	(5,409)	(6,208)
Other assets	(294)	(1,007)	267
Accounts payable	3,496	(2,172)	1,011
Accrued liabilities	744	3,909	906
Income taxes payable	(205)	1,944	(317)
Other operating activities	430	339	978
Investments and marketable securities	(23,967)	(37,853)	(24,154)
NET CASH PROVIDED BY OPERATING ACTIVITIES	31,731	1,795	2,536
Cash flows from investing activities:			
Purchases of property and equipment	(25,615)	(10,241)	(11,274)
Payment for acquisitions	—	—	(4,158)
Purchases of investments and marketable securities	—	(14,549)	(14,930)
Sales of investments and marketable securities	—	27,304	22,802
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(25,615)	2,514	(7,560)
Cash flows from financing activities:			
Proceeds from exercise of stock options	2,028	1,983	923
Common stock retired in Eltron merger	(8,092)	—	—
Common stock purchased in connection with RJS merger	—	—	(776)
Issuance (repayment) of short-term notes payable	(180)	(819)	(825)
Payments for obligation under capital lease	(65)	(61)	(59)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(6,309)	1,103	(737)
Effect of exchange rate changes on cash	659	(946)	1,474
Net increase (decrease) in cash and cash equivalents	466	4,466	(4,287)
Cash and cash equivalents at beginning of year	10,925	6,459	10,746
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 11,391	\$ 10,925	\$ 6,459
Supplemental disclosures of cash flow information:			
Interest paid	\$ 425	\$ 85	\$ 116
Income taxes paid	22,624	30,060	21,853
Supplemental disclosures of noncash transactions			
Tax benefit arising from exercise of options	277	1,003	576
Assumption of liabilities and obligations in connection with acquisition of Privilege, S.A.	—	—	1,323
Cancellation of shares issued in connection with RJS merger	—	(253)	—

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(AMOUNTS IN THOUSANDS)

NOTE 1 DESCRIPTION OF BUSINESS

Zebra Technologies Corporation and its wholly-owned subsidiaries (the Company) design, manufacture, sell, and support a broad line of bar code label and plastic card printers, self-adhesive labeling materials, plastic card supplies, thermal transfer ribbons and bar code label design software. These products are used principally in automatic identification (auto ID), data collection and personal identification applications and are distributed worldwide through a multi-channel reseller network to a wide cross section of industrial, service and government organizations.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation. The accompanying financial statements have been prepared on a consolidated basis to include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts, transactions, and unrealized profit have been eliminated in consolidation.

Research and Development Costs. Research and development costs are expensed as incurred.

Cash Equivalents. Cash equivalents consist primarily of short-term treasury securities. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Investments and Marketable Securities. Investments and marketable securities at December 31, 1998, consisted of U.S. government securities, state and municipal bonds, partnership interests, and equity securities, which are held indirectly in diversified funds actively managed by investment professionals. The Company applies the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FASB 115). Under FASB 115, the Company classifies its debt and marketable equity securities in one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities that the Company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of discounts or premiums. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding

gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of shareholders' equity until realized.

Inventories. Inventories are stated at the lower of cost or market, and cost is determined by the first-in, first-out (FIFO) method.

Property and Equipment. Property and equipment is stated at cost. Depreciation and amortization is computed primarily using the straight-line method over the estimated useful lives of the various classes of property and equipment, which are 30 years for buildings and range from 3 to 10 years for machinery and equipment. Property and equipment held under a capital lease is amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

Income Taxes. The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (FASB 109). Under the asset and liability method of FASB 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under FASB 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Advertising. Advertising costs are expensed as incurred. Advertising expenses for the years ended December 31, 1998, 1997, and 1996 totaled \$3,931,000, \$4,767,000 and \$4,070,000, respectively.

Warranty. The Company provides warranty coverage of up to one year on printers against defects in material and workmanship. A provision for warranty expense is recorded at the time of shipment. To date, the Company has not experienced any significant warranty claims.

Stock-based Compensation. The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*.

Reclassifications. Certain amounts in the prior period financial statements have been reclassified to conform to the current period's presentation.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation. The balance sheets of the Company's foreign subsidiaries are translated into U.S. dollars using the year-end exchange rate, and statement of earnings items are translated using the average exchange rate for the year. The resulting translation gains or losses are recorded as a separate component of shareholders' equity as a cumulative translation adjustment.

NOTE 3 BUSINESS COMBINATIONS

Eltron. On October 28, 1998, the Company acquired all of the outstanding capital stock of Eltron International, Inc. (Eltron), a manufacturer of bar code printers and related accessories, in exchange for 6,916,951 shares of the Company's Class B Common Stock (see Note 14 for information concerning the Company's common stock), which had a market value of approximately \$201 million at the time of the acquisition.

The acquisition was accounted for as a pooling of interests and, accordingly, the consolidated financial statements have been restated as if the companies had been combined for all periods presented. Merger costs reported in the consolidated statement of earnings for the year ended December 31, 1998 include investment banking and other professional fees, write-downs of certain assets, employee severance, and other acquisition related charges. Included in accrued liabilities as of December 31, 1998, is \$4,181,000 related to these costs. The following information (in thousands) reconciles net sales and income from continuing operations of the companies as previously reported in the companies' Annual Report on Form 10-K for the year ended December 31, 1997 with the amounts presented in the accompanying consolidated statements of earnings for the years ended December 31, 1997 and 1996, as well as the separate results of operations of Eltron for the period from January 1, 1998 through October 28, 1998, representing the period in 1998 preceding the acquisition.

	Zebra (*)	Eltron	Total
1998			
Net sales		\$ 100,043	
Income from continuing operations		9,090	
1997			
Net sales	\$ 192,071	105,029	\$ 297,100
Income from continuing operations	42,810	11,637	54,447
1996			
Net sales	163,977	88,510	252,487
Income from continuing operations	30,853	7,099	37,952

(*) Represents the historical results of Zebra without considering the effect of the pooling of interests business combination with Eltron.

Privilege, S.A. Effective January 1, 1996, the Company purchased all of the outstanding capital stock of Privilege, S.A. (Privilege), a French company primarily engaged in the design, manufacture and distribution of custom plastic card printers. This transaction has been accounted for as a purchase, and acquired in-process technology valued at \$2,500,000 was expensed immediately. The purchase price paid by the Company was approximately \$3,200,000 in cash and the assumption of approximately \$1,300,000 in trade liabilities and debt. The assets acquired by the Company consisted of trade receivables, inventories, equipment and technology. The results of operations relating to Privilege are included with those of the Company from January 1, 1996.

RJS, Incorporated. Effective March 1, 1996, the Company acquired RJS, Incorporated (RJS) in a business combination accounted for as a pooling of interests. RJS is a manufacturer of bar code label printers, bar code verifiers and verified printing systems located in Monrovia, California.

In January 1998, Printronix Inc., a leading manufacturer of computer printers, acquired the assets and rights to the bar code verification business and the RJS name from the Company for approximately \$2,800,000. In the first quarter of 1998, the Company recorded a tax affected gain on the sale of approximately \$250,000. The Company retained the rights to the in-line verification technology for use in its line of integrated verified printing systems, as well as the QualaBar and ThermaBar industrial printer lines.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 EARNINGS PER SHARE

For the years ended December 31, 1998, 1997, and 1996, earnings per share were computed in accordance with Statement of Financial Accounting Standards No. 128, *Earnings Per Share*, which the Company adopted during the fourth quarter of 1997. Earnings per share are calculated as follows:

	1998	1997	1996
BASIC EARNINGS PER SHARE:			
Income from continuing operations	\$ 40,069	\$ 54,447	\$ 37,952
Weighted average common shares outstanding	30,919	30,897	30,696
Per share amount	\$ 1.30	\$ 1.76	\$ 1.24
DILUTED EARNINGS PER SHARE:			
Income from continuing operations	\$ 40,069	\$ 54,447	\$ 37,952
Weighted average common shares outstanding	30,919	30,897	30,696
Add: Effect of dilutive securities - stock options	257	483	573
Diluted weighted average and equivalent common shares outstanding	31,176	31,380	31,269
Per share amount	\$ 1.29	\$ 1.74	\$ 1.21

Total potentially dilutive securities, which were excluded from the earnings per share calculation, consisted of stock options for which the exercise price was greater than the average market price of the Class A Common Stock amounting to 227,250, 246,855 and 178,000 at December 31, 1998, 1997 and 1996.

NOTE 5 INVESTMENTS AND MARKETABLE SECURITIES

The amortized cost, gross unrealized holding gains, gross unrealized holding losses and aggregate fair value of investment securities at December 31, 1998 were as follows:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available for sale:				
State and municipal bonds	\$ 6,928	—	—	\$ 6,928
Trading Securities:				
U.S. government and agency securities	8,981	147	(6)	9,122
State and municipal bonds	82,869	469	(30)	83,308
Equity securities	16,456	589	(117)	16,928
Partnership interests	24,500	3,162	—	27,662
Other	7,487	—	(158)	7,329
	140,293	4,367	(311)	144,349
	\$ 147,221	\$ 4,367	\$ (311)	\$ 151,277

The amortized cost, gross unrealized holding gains, gross unrealized holding losses and aggregate fair value of investment securities at December 31, 1997 were as follows:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available for sale:				
State and municipal bonds	\$ 6,696	—	—	\$ 6,696
Trading Securities:				
U.S. government and agency securities	12,163	311	(4)	12,470
State and municipal bonds	63,584	231	(49)	63,766
Equity securities	7,812	431	(8)	8,235
Partnership interests	19,500	4,313	—	23,813
Other	13,499	—	(84)	13,415
	116,558	5,286	(145)	121,699
	\$ 123,254	\$ 5,286	\$ (145)	\$ 128,395

The contractual maturities of debt securities at December 31, 1998 were as follows:

	Fair Value
Due within one year	\$ 59,724
Due after one year through five years	37,195
Due after five years	9,768
	\$ 106,687

Using the specific identification method, the proceeds and realized gains on the sales of an available-for-sale security during 1997 were \$11,506,000 and \$5,458,000, respectively.

NOTE 6 RELATED-PARTY TRANSACTIONS

Unique Building Corporation (Unique), an entity controlled by certain officers and shareholders of the Company, leases a facility and equipment to the Company under a lease described in Note 11. Management believes that the lease payments are substantially consistent with amounts that could be negotiated with third parties on an arm's-length basis.

Interest expense and lease payments related to the leases were included in the consolidated financial statements as follows:

	Unique Operating Lease Payments	Interest Expense on Unique Capital Lease
1998	\$ 1,323	\$ 4
1997	1,261	7
1996	1,227	10

NOTE 7 INVENTORIES

The components of inventories are as follows:

	December 31, 1998	December 31, 1997
Raw material	\$ 21,292	\$ 28,350
Work in process	2,838	3,684
Finished goods	15,554	11,826
Total inventories	\$ 39,684	\$ 43,860

NOTE 8 PROPERTY AND EQUIPMENT

Property and equipment, which includes assets under capital leases, is comprised of the following:

	December 31, 1998	December 31, 1997
Buildings	\$ 10,256	\$ —
Land	1,910	—
Machinery, equipment and tooling	25,005	20,696
Machinery and equipment under capital leases	574	574
Furniture and office equipment	4,125	8,500
Computers and software	21,589	10,834
Automobiles	514	505
Leasehold improvements	1,444	1,442
	65,417	42,551
Less accumulated depreciation and amortization	26,567	19,413
Net property and equipment	\$ 38,850	\$ 23,138

NOTE 9 INCOME TAXES

The provision for income taxes consists of the following:

	1998	1997	1996
Current:			
Federal	\$ 17,194	\$ 26,553	\$ 17,356
State	2,822	3,599	2,229
Foreign	2,941	3,528	2,235
Deferred:			
Federal	2,197	(3,250)	188
State	(202)	(627)	(72)
Foreign	-	116	—
Total	\$ 24,952	\$ 29,919	\$ 21,936

The provision for income taxes differs from the amount computed by applying the U.S. statutory Federal income tax rate of 35%. The reconciliation of statutory and effective income taxes is presented below:

	1998	1997	1996
Provision computed at statutory rate	\$ 22,747	\$ 28,608	\$ 20,283
State income tax (net of Federal tax benefit)	2,044	2,284	1,557
Tax-exempt interest and dividend income	(1,369)	(635)	(351)
Tax benefit of exempt foreign trade income	(1,227)	(441)	(634)
Acquisition related items	1,006	109	1,347
Other	1,751	(6)	(266)
Provision for income taxes	\$ 24,952	\$ 29,919	\$ 21,936

Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. Based on management's assessment, it is more likely than not that the deferred tax assets will be realized through future taxable earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Temporary differences that give rise to deferred tax assets and liabilities are as follows:

	December 31, 1998	December 31, 1997
Deferred tax assets:		
Deferred rent-building	\$ 77	\$ 103
Capital equipment lease	20	46
Accrued vacation	595	340
Inventory items	4,220	1,484
Allowance for doubtful accounts	667	577
Net operating loss carryforwards	—	1,222
Other accruals	—	3,451
Acquisition related items	473	404
Gross deferred tax assets	6,052	7,627
Valuation allowance	—	(427)
Net deferred tax assets	6,052	7,200
Deferred tax liabilities:		
Unrealized gain on securities	(440)	(179)
Depreciation	(1,587)	(1,254)
Other	(820)	(567)
Total deferred tax liabilities	(2,847)	(2,000)
Net deferred tax asset	\$ 3,205	\$ 5,200

The valuation allowance decreased \$427,000 and \$424,000 for the years ended December 31, 1998 and 1997, respectively.

NOTE 10 401(K) SAVINGS AND PROFIT SHARING PLANS

The Company has a Retirement Savings and Investment Plan (the 401(k) Plan) that is intended to qualify under Section 401(k) of the Internal Revenue Code. Qualified employees may participate in the Company's 401(k) Plan by contributing up to 15% of their gross earnings to the plan subject to certain Internal Revenue Service restrictions. The Company matches each participant's contribution of up to 6% of gross earnings at the rate of 50%. The Company may contribute additional amounts to the 401(k) Plan at the discretion of the Board of Directors, subject to certain legal limits.

The Company has a discretionary profit-sharing plan for qualified employees, to which it contributed 3.4% of eligible earnings for 1998, 3.3% for 1997, and 3.0% for 1996. Participants are not permitted to make contributions under the profit-sharing plan.

Company contributions to these plans, which were charged to operations, approximated the following:

	401(k)	Profit Sharing	Total
1998	\$ 620	\$ 970	\$ 1,590
1997	\$ 548	\$ 847	\$ 1,395
1996	\$ 398	\$ 513	\$ 911

NOTE 11 COMMITMENTS AND CONTINGENCIES

Leases. In September 1989, the Company entered into a lease agreement for its Vernon Hills facility and certain machinery, equipment, furniture and fixtures with Unique Building Corporation. The facility portion of the lease is treated as an operating lease. An amendment to the lease dated June 1996 extended the term of the lease through March 31, 2008. The lease agreement includes a modification to the base monthly rental which goes into effect if the prescribed rent payment is less than the aggregate principal and interest payments required to be made by Unique under an Industrial Revenue Bond (IRB). Under the portion of the lease agreement with Unique which is accounted for as a capital lease, the Company leases machinery, equipment, furniture and fixtures at a monthly rental of \$5,725 for a ten-year period. The assets under these leases were fully depreciated as of December 31, 1998 and 1997.

Minimum future obligations under noncancelable operating leases and future minimum capital lease payments as of December 31, 1998 are as follows:

	Capital Lease	Operating Leases
1999	\$ 52	\$ 2,403
2000	—	2,304
2001	—	2,060
2002	—	2,024
2003	—	2,104
Thereafter	—	12,069
Total minimum lease payments	52	\$ 22,964
Less amount representing interest	1	
Present value of minimum payments	51	
Less current portion of obligation under capital lease	51	
Long-term portion of obligation under capital lease	\$ —	

Rent expense for operating leases charged to operations for the years ended December 31, 1998, 1997, and 1996 was \$2,898,000, \$2,871,000, and \$2,395,000, respectively.

Letter of credit. In connection with the lease agreements described above, the Company has guaranteed Unique's full and prompt payment under Unique's letter of credit agreement with a bank. The liability of the Company under this guaranty as of December 31, 1998 is \$700,000, which is the limit of the Company's guaranty throughout the term of the IRB.

Lines of credit. In December 1992, the Company established a \$6,000,000 unsecured line of credit and an additional \$4,000,000 unsecured revocable line with a bank. Borrowings under these lines bear interest indexed at either the prime rate or 100 basis points over the London Interbank Offered Rate, at the Company's discretion. The Company had \$184,700 outstanding at December 31, 1998. The lines of credit expire on February 28, 2000.

In 1997, the Company entered into an agreement for a revolving line of credit with a bank. The revolving credit facility allows the Company to borrow up to \$10,000,000 on an unsecured basis. Borrowings under the revolving credit facility bear interest at the bank's prime rate. Under the terms of the revolving credit facility, the Company is not able to enter into certain transactions or declare dividends without receiving prior written consent from the bank and is required to comply with certain covenants as well as maintain certain debt to net worth ratios, current ratio and minimum net worth requirements. The revolving credit agreement expires in April 1999. There was no utilization of the credit line during 1998.

Derivative instruments. In the normal course of business, portions of the Company's operations are subject to fluctuations in currency values. The Company addresses these risks through a controlled program of risk management that includes the use of derivative financial instruments.

The Company enters into foreign exchange forward contracts to manage exposure to fluctuations in foreign exchange rates to the funding of its United Kingdom operations. The Company accounts for such contracts by recording any unrealized gains or losses in income each reporting period. At December 31, 1998, the Company had entered into foreign exchange forward contracts, which provide for purchases of approximately 1,201,616 pounds sterling per month through February 1999. At December 31, 1998 and 1997, the notional principal amounts of outstanding forward contracts were \$4,057,000 and \$6,211,000, respectively.

NOTE 12 SEGMENT DATA AND EXPORT SALES

The Company operates in one industry segment. Information regarding the Company's operations by geographic area for the years ended December 31, 1998, 1997, and 1996 is included in the following table. These amounts are reported in the geographic area where the final sale originates.

	Domestic	Europe	Other	Total
1998				
Net sales	\$ 238,354	\$ 96,397	\$ 1,232	\$ 335,983
Identifiable assets	305,172	4,049	781	310,002
1997				
Net sales	222,340	74,760	—	297,100
Identifiable assets	247,766	22,650	31	270,447
1996				
Net sales	193,001	59,486	—	252,487
Identifiable assets	199,215	19,417	—	218,632

NOTE 13 DISCONTINUED BUSINESS OPERATIONS

As of June 28, 1997, the Company made the decision to discontinue the operations of its subsidiary, Zebra Technologies VTI (Zebra VTI). The discontinuance of Zebra VTI and its related PC-retail channel resulted in a one-time charge of \$2,363,000 before income tax benefits, which was recorded in the second quarter of 1997. The one-time charge includes a provision for expected product returns from the present retail channel partners, provision for slow moving/obsolete product, and provisions for estimated contingent liabilities. Additionally, the remaining goodwill and intangible assets of \$1,833,000 were written off as part of the charge to discontinued operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 SHAREHOLDERS' EQUITY

Holders of Class A Common Stock are entitled to one vote per share. Holders of Class B Common Stock are entitled to ten votes per share. Holders of Class A and Class B Common Stock vote together as a single class on all actions submitted to a vote of shareholders, except in certain circumstances. If at any time the number of outstanding shares of Class B Common Stock represents less than 10% of the total number of outstanding shares of both classes of common stock, then at that time such outstanding shares of Class B Common Stock will automatically convert into an equal number of shares of Class A Common Stock.

Class A Common Stock has no conversion rights. A holder of Class B Common Stock may convert the Class B Common Stock into Class A Common Stock, in whole or in part, at any time and from time to time. Shares of Class B Common Stock convert into shares of Class A Common Stock on a share-for-share basis.

Holders of Class A and Class B Common Stock are entitled to receive cash dividends equally on a per-share basis, if and when such dividends are declared by the Company's Board of Directors. In the case of any stock dividend paid, holders of Class A Common Stock are entitled to receive the same percentage dividend (payable in shares of Class A Common Stock) as the holders of Class B Common Stock receive (payable in shares of Class B Common Stock).

Holders of Class A and Class B Common Stock share with each other on a ratable basis as a single class in the net assets of the Company in the event of liquidation.

NOTE 15 STOCK OPTION AND PURCHASE PLANS

As of December 31, 1998, the Company has five stock option and stock purchase plans, described below.

The Board of Directors and shareholders adopted the Zebra Technologies Corporation Stock Option Plan (the 1991 Plan), effective as of August 1, 1991. A total of 400,000 shares of Class A Common Stock has been authorized and reserved for issuance under the 1991 Plan. Under this plan, the Company has granted only nonqualified stock options. As of December 31, 1998, 177,763 shares were available under the plan. These options have an exercise price equal to the closing market price of the Company's stock on the date of grant. Typically, the options vest in annual installments of 15% on the first anniversary, 17.5% on the second anniversary, 20% on the third anniversary, 22.5% on the fourth anniversary, and 25% on the fifth anniversary of the grant

date. Upon full vesting, the options have a legal life of two years from the date of vesting. The specific provisions of any grant are determined by the Board of Directors.

The Board of Directors and shareholders also adopted a Directors' Stock Option Plan, which reserves 80,000 shares of Class A Common Stock for issuance under the plan. As of December 31, 1998, 12,000 shares were available under the plan. All options granted under this plan are exercisable immediately upon grant at a price per share equal to the closing market price of the Company's Class A Common Stock on the date of grant. Options granted to the Board of Directors carry a seven year expiration period, however, should a member of the board discontinue service on the Board of Directors, he is limited to a two year period to exercise all outstanding options.

The Board of Directors and shareholders adopted an employee stock purchase plan (Stock Purchase Plan) and have reserved 300,000 shares of Class A Common Stock for issuance thereunder. Under this plan, employees who work a minimum of 20 hours per week may elect to withhold up to 8.5% of their cash compensation through regular payroll deductions to purchase shares of Class A Common Stock from the Company over a period not to exceed 12 months at a purchase price per share equal to the lesser of: (1) 85% of the fair market value of the shares as of the date of the grant, or (2) 85% of the fair market value of the shares as of the date of purchase. As of December 31, 1998, 147,361 shares have been purchased under the plan.

Under the Stock Purchase Plan, the Company has granted only nonqualified stock options. These options are granted either on January 1 or July 1 of the current year and expire at the end of the year. Therefore, the options have a legal life of six months to one year, and typically vest upon grant. The specific provisions of any grant are determined by the Board of Directors.

The Company's Board of Directors adopted the 1997 Stock Option Plan, effective February 11, 1997. On October 26, 1998, the Company announced an increase in the amount of reserved shares of Common Stock for issuance under the plan to 2,000,000 from 531,500 shares. The 1997 Stock Option Plan is a flexible plan that provides the Option Committee broad discretion to fashion the terms of the awards to provide eligible participants with stock-based incentives, including: (i) nonqualified and incentive stock options for the purchase of the Company's Class A Common Stock and (ii) dividend equivalents.

The persons eligible to participate in the 1997 Stock Option Plan are directors, officers, and employees of the Company or any subsidiary of the Company who, in the opinion of the Option Committee, are in a position to make contributions to the growth, management, protection and success of the Company or its subsidiaries. As of December 31, 1998, 569,452 shares were available under the plan.

The options granted under the 1997 Stock Option Plan have an exercise price equal to the closing market price of the Company's stock on the date of grant. The options generally vest over three- to five-year periods and have a legal life of ten years from the date of grant. The specific provisions of any grant are determined by the Board of Directors.

The Company's Board of Directors adopted the 1997 Director Plan, effective February 11, 1997. The 1997 Director Plan provides for the issuance of options to purchase up to 77,000 shares of Class A Common Stock, which shares are reserved and available for purchase upon the exercise of options granted under the 1997 Director Plan. Only directors who are not employees or officers of the Company are eligible to participate in the 1997 Director Plan. Under the 1997 Director Plan, each non-employee director was granted, on the effective date of the plan, an option to purchase 15,000 shares of Class A Common Stock, and each non-employee director subsequently elected to the Board will be granted an option to purchase 15,000 shares of Class A Common Stock on the date of his or her election. Options granted under the 1997 Director Plan provide for the purchase of Class A Common Stock at a price equal to the fair market value on the date of grant. If there are not sufficient shares remaining and available to all non-employee directors eligible for an automatic grant at the time at which an automatic grant would otherwise be made, then each eligible non-employee director shall receive an option to purchase a pro rata number of shares. As of December 31, 1998, 32,000 shares were available under the plan.

Unless otherwise provided in an option agreement, options granted under the 1997 Director Plan shall become exercisable in five equal increments beginning on the date of the grant and on each of the first four anniversaries thereafter. All options expire on the earlier of (a) ten years following the grant date or (b) the second anniversary of the termination of the non-employee director's directorship for any reason other than due to death or disability (as defined in the 1997 Director Plan).

The Company applies Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, in accounting for its plans. No compensation cost has been recognized for its fixed stock option plans and its stock purchase plan. Had compensation cost for the Company's stock option and stock purchase plans been determined consistent with Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (FASB 123), the Company's income from continuing operations and earnings per share from continuing operations would have been as follows:

	1998	1997	1996
Income from continuing operations:			
As reported	\$ 40,069	\$ 54,447	\$ 37,952
Pro forma	37,785	52,215	37,272
Basic earnings per share from continuing operations:			
As reported	\$1.30	\$1.76	\$1.24
Pro forma	1.22	1.69	1.21
Diluted earnings per share from continuing operations:			
As reported	\$ 1.29	\$ 1.74	\$1.21
Pro forma	1.21	1.66	1.19

For purposes of calculating the compensation cost consistent with FASB 123, the fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for stock option grants in 1998, 1997, and 1996, respectively: option price, which equals the fair market value at the date of grant; expected dividend yield of 0% for each period; expected volatility of 55%, 51%, and 53%; risk-free interest rate of 4.75%, 5.71%, and 6.21%; and expected weighted-average life of five years.

The fair value of the employees' purchase rights pursuant to the Stock Purchase Plan are estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions used for purchase rights granted in 1998, 1997, and 1996, respectively: fair market value of \$28.75, \$23.63, and \$22.10; option price of \$24.44, \$20.09, and \$18.79; expected dividend yield of 0% for each period; expected volatility of 50.94%, 50.65%, and 62.17%; risk-free interest rate of 4.60%, 5.59%, and 5.87%; and expected lives of six months to one year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock option activity for the years ended December 31, 1998, 1997, and 1996 was as follows:

Fixed Options	1998		1997		1996	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	1,180,293	\$ 23.31	722,654	\$ 18.90	458,239	\$ 12.35
Granted	368,550	35.18	567,410	26.12	324,750	26.62
Exercised	(66,767)	18.03	(109,771)	8.83	(55,335)	8.96
Canceled	(65,263)	25.49	—	—	(5,000)	29.25
Outstanding at end of year	1,416,813	26.55	1,180,293	23.31	722,654	18.90
Options exercisable at end of year	568,877	23.06	330,971	23.05	159,324	14.95

The following table summarizes information about fixed stock options outstanding at December 31, 1998:

Range of Exercise Prices	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	Number of Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$ 3.33-\$12.38	124,027	4.71 years	\$ 8.38	116,305	\$ 8.22
\$ 17.13-\$24.17	343,381	6.83 years	\$ 22.16	158,346	\$ 22.02
\$ 24.50-\$24.50	295,250	8.12 years	\$ 24.50	52,350	\$ 24.50
\$ 25.19-\$32.29	313,550	7.98 years	\$ 29.35	144,800	\$ 28.45
\$ 32.36-\$38.75	340,605	9.12 years	\$ 36.77	97,076	\$ 33.70

NOTE 16 QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Quarterly results of operations for periods prior to the fourth quarter of 1998 reflect amounts previously reported in the Company's quarterly reports on Form 10-Q or annual report on Form 10-K for the year ended December 31, 1997. Restated amounts reflect the effect of the merger with Eltron, which was accounted for on a pooling-of-interests basis.

(Amounts in thousands, except per share data)

1998	First Quarter (1)	Second Quarter (1)	Third Quarter (1)	Fourth Quarter (2)
Net sales previously reported	\$ 50,214	\$ 55,353	\$ 57,354	
Restated	80,798	87,040	88,068	\$ 80,077
Gross profit previously reported	26,140	28,790	30,677	
Restated	38,861	41,701	42,381	32,867
Operating expense previously reported	12,960	12,860	13,680	
Restated	20,752	20,464	21,009	31,949
Operating income previously reported	13,180	15,930	16,997	
Restated	18,109	21,237	21,372	918
Income from continuing operations previously reported	10,434	11,288	11,230	
Restated	13,163	14,037	13,213	(344)
Net income previously reported	10,434	11,288	11,230	
Restated	13,163	14,037	13,213	(344)
Basic earnings per share from continuing operations previously reported	\$ 0.43	\$ 0.46	\$ 0.46	
Restated	0.42	0.45	0.43	\$ (0.01)
Diluted earnings per share from continuing operations previously reported	\$ 0.43	\$ 0.46	\$ 0.46	
Restated	0.42	0.45	0.42	\$ (0.01)
Basic earnings per share previously reported	\$ 0.43	\$ 0.46	\$ 0.46	
Restated	0.42	0.45	0.43	\$ (0.01)
Diluted earnings per share previously reported	\$ 0.43	\$ 0.46	\$ 0.46	
Restated	0.42	0.45	0.42	\$ (0.01)

(Amounts in thousands, except per share data)

1997	First Quarter (3)	Second Quarter	Third Quarter	Fourth Quarter
Net sales previously reported	\$ 41,009	\$ 47,844	\$ 49,889	\$ 53,329
Restated	64,179	75,358	75,498	82,065
Gross profit previously reported	20,406	24,298	25,011	28,485
Restated	30,730	36,361	36,624	39,993
Operating expense previously reported	9,234	11,768	11,360	13,063
Restated	15,533	18,531	17,685	20,697
Operating income previously reported	11,172	12,530	13,651	15,422
Restated	15,197	17,830	18,939	19,296
Income from continuing operations previously reported	11,527	9,645	9,945	11,693
Restated	14,135	12,997	13,453	13,862
Net income previously reported	11,235	7,282	9,945	11,693
Restated	13,843	10,634	13,453	13,862
Basic earnings per share from continuing operations previously reported	\$ 0.48	\$ 0.40	\$ 0.41	\$ 0.48
Restated	0.46	0.42	0.44	0.45
Diluted earnings per share from continuing operations previously reported	\$ 0.48	\$ 0.40	\$ 0.41	\$ 0.48
Restated	0.45	0.41	0.43	0.44
Basic earnings per share previously reported	\$ 0.46	\$ 0.30	\$ 0.41	\$ 0.48
Restated	0.45	0.34	0.44	0.45
Diluted earnings per share previously reported	\$ 0.46	\$ 0.30	\$ 0.41	\$ 0.48
Restated	0.44	0.34	0.43	0.44

(1) Reflects the elimination of intercorporate investment in Eltron International, Inc., and the related tax effect.

(2) Reflects a pretax charge for merger costs of \$8,080 relating to the Company's merger with Eltron International, Inc.

(3) Reflects a pretax charge for acquired-in-process technology of \$3,617 relating to the Company's acquisition of Fenestra Computer Services and Privilege, S.A.

NOTE 17 MAJOR CUSTOMERS

The Company has two customers which each have net sales in excess of 10% of total net sales in at least one of the fiscal years ended December 31, 1998, 1997, and 1996. The Peak Technologies Group, Inc. (Peak) represents net sales of 9.5%, 10.9%, and 12.8%, respectively. United Parcel Service represents net sales of 10.3%, 8.7%, and 10.7%, respectively.

Independent Auditors' Report

**TO THE BOARD OF DIRECTORS AND SHAREHOLDERS
ZEBRA TECHNOLOGIES CORPORATION:**

We have audited the accompanying consolidated balance sheets of Zebra Technologies Corporation and Subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings, comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Eltron International, Inc., a wholly-owned subsidiary, which statements reflect total assets constituting 25 percent as of December 31, 1997 and net sales constituting 35 percent in 1997 and 1996 of related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to the amounts for Eltron International, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits, and the report of the other auditors, provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Zebra Technologies Corporation and Subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

KPMG LLP

**CHICAGO, ILLINOIS
FEBRUARY 24, 1999**

Shareholder Information

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INDEPENDENT AUDITORS

KPMG LLP
Chicago, Illinois

CORPORATE COUNSEL

Katten Muchin & Zavis
Chicago, Illinois

INVESTOR RELATIONS

For corporate or product information please contact the Corporate Office.

FORM 10-K REPORT

You may receive a free copy of the Zebra Technologies Corporation Form 10-K Report filed with the Securities and Exchange Commission by contacting the Investor Relations Department at the Corporate Headquarters.

WEB SITE

Investors are invited to learn more about Zebra Technologies by accessing the Company's web site at www.zebra.com

STOCK INFORMATION: PRICE RANGE AND COMMON STOCK

The Company's Class A Common Stock is traded on the Nasdaq Stock Market under the symbol ZBRA. The following table shows the high and low trade prices for each quarter in 1998 and 1997, as reported by Nasdaq. No market exists for the Company's Class B Common Stock. The shares of Class B Common Stock are convertible on a one-for-one basis into shares of Class A Common Stock at the option of the holder.

Fiscal 1998	High	Low
First Quarter	\$ 38.50	\$ 25.50
Second Quarter	44.63	34.75
Third Quarter	42.63	27.00
Fourth Quarter	37.00	25.00

Fiscal 1997	High	Low
First Quarter	\$ 27.75	\$ 21.25
Second Quarter	32.00	21.50
Third Quarter	36.00	26.56
Fourth Quarter	38.25	29.00

Source: The Nasdaq Stock Market

At March 19, 1999, the last reported price for the Class A Common Stock was \$23.938 per share. There were 652 shareholders of record for the Company's Class A Common Stock and 40 shareholders of record for the Company's Class B Common Stock.

DIVIDEND POLICY

Since the Company's initial public offering in 1991, the Company has not declared any cash dividends or distributions on its capital stock. The Company intends to retain its earnings to finance future growth and therefore does not anticipate paying any cash dividends in the foreseeable future.

NUMBER OF EMPLOYEES

The Company had approximately 1,500 associates as of March 19, 1999.