

SECURITIES AND EXCHANGE COMMISSION

FORM SB-2

Optional form for registration of securities to be sold to the public by small business issuers

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FILER

XYBERNAUT CORP

CIK: **1013148** | IRS No.: **541799851** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **SB-2** | Act: **33** | File No.: **333-65123** | Film No.: **98718961**
SIC: **3576** Computer communications equipment

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM SB-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

XYBERNAUT CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (Jurisdiction of Incorporation)	3571 (Primary Standard Industrial Classification Code Number)	54-1799851 (I.R.S. Employer Identification Number)
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12701 Fair Lakes Circle, Fairfax, Virginia 22033, (703) 631-6925
(Address and telephone number
of registrant's principal executive offices)

Edward G. Newman
12701 Fair Lakes Circle
Fairfax, Virginia 22033
(703) 631-6925
(Name, address and telephone number of agent for service)

Copies of communications to:

Martin Eric Weisberg, Esq.
Parker Chapin Flattau & Klimpl, LLP
1211 Avenue of the Americas
New York, New York 10036
(212) 704-6000

Approximate date of proposed commencement of sale to public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, please check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. _____

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier registration statement for the same offering. _____

If the delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

<TABLE>
<CAPTION>

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price per Share (2)	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
<S>	<C>	<C>	<C>	
Common Stock, \$.01 par value per share.....	1,995,000	\$5.0469	\$10,068,565	\$2,970.21
Common Stock, \$.01 par value per share.....	105,000	\$11.3555 (3)	\$1,192,328	\$351.74
Total Registration Fee.....				\$3,321.95

</TABLE>

- (1) Represents the shares of Common Stock being registered for offer by the Company in connection with a proposed financing (the "Financing Arrangement"). Pursuant to Rule 416, the shares of Common Stock offered hereby also include such presently indeterminate number of shares of Common Stock as shall be issued by the Company in connection with the Financing Arrangement between the Company and the investor. Such number of shares is subject to adjustment and could be materially less than such estimated amount depending upon factors that cannot be predicted by the Company at this time, including, among others, the future market price of the Common Stock. This presentation is not intended to constitute a prediction as to the future market price of the Common Stock or as to the number of shares of Common Stock issuable upon exercise of the Warrants. See "Risk Factors -- Dilution"; and "Description of Securities."
- (2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) and (g) of the Securities Act of 1933, as amended (the "Securities Act"); based on the average (\$5.0469) of the bid ((\$5.0313) and asked (\$5.0625) price on the Nasdaq SmallCap Market on September 25, 1998.
- (3) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(g) of the Securities Act, based on, according to the terms of the warrant, 225% of the average price (\$5.0469) of the Nasdaq SmallCap Market on September 25, 1998.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such state.

SUBJECT TO COMPLETION, DATED SEPTEMBER __, 1998

PROSPECTUS

2,100,000 Shares*

XYBERNAUT CORPORATION

This Prospectus covers an aggregate of 2,100,000 shares (the "Shares") of common stock, par value \$.01 per share (the "Common Stock"), of Xybernaut Corporation, a Delaware corporation (the "Company"), which may be offered, from time to time, by the Company or the selling stockholder named herein. See "Description of Securities." The Company is offering the Shares in connection with a proposed financing (the "Financing Arrangement") whereby the Company, at its option, may issue up to (a) \$31,200,000 of Common Stock to an investor (the "Selling Stockholder") over a twelve month period based on weekly, monthly or quarterly draw downs at a per share purchase price equal to the lesser of (i) 100% of the average of the daily volume weighted average price of the Common Stock on NASDAQ SmallCap Market for a certain number of consecutive trading days preceding the funding date of the draw down and (ii) \$8.00; provided, however, that if the purchase price of the Common Stock is less than \$3.00, the investor

will not be obligated to fund such weekly, monthly or quarterly draw down, (b) \$31,200,000 of Common Stock pursuant to the option granted by the Company to the investor to purchase an additional amount of Common Stock up to the maximum amount of each draw down (the "Call Options"), and (c) approximately 105,000 Shares, which Shares will be issued upon exercise of the warrants which the Company will issue to the investor at each draw down (the "Warrants"). Each Warrant will give the investor the right to purchase shares of Common Stock at an exercise price of 225% of the average daily price on the date the Company furnishes the Selling Stockholder with a draw down notice. See "Financing Arrangement."

The actual number of Shares of Common Stock offered by the Company will, in certain cases, be subject to increase or decrease dependent upon the purchase price per share in effect on the actual date of sale by the Company. The Company will receive the net proceeds from the aggregate number of draw downs requested by the Company, the aggregate number of Call Options exercised by the investor and the aggregate exercise price of the warrants exercised by the investor. Such aggregate net proceeds will be used by the Company for general corporate purposes. The Company will not receive any proceeds from the sale of the Shares by the Selling Stockholder. See "Use of Proceeds." The Company has agreed to bear all expenses relating to this registration, other than underwriting discounts and commissions. In addition, the Company has agreed to indemnify the Selling Stockholder against certain liabilities, including liabilities under the Securities Act. See "Selling Stockholder" and "Plan of Distribution."

The Common Stock is quoted on the NASDAQ SmallCap Market under the symbol "XYBR". On September 24, 1998, the closing bid price of the Common Stock as reported by NASDAQ was \$5.4375.

*Pursuant to Rule 416, the shares of Common Stock offered hereby include such presently indeterminate number of shares of Common Stock as shall be issued by the Company to the investor pursuant to the Financing Arrangement upon exercise of warrants to be issued to the investor thereunder. Such number of shares is subject to adjustment and could be materially less than such estimated amount depending upon factors that cannot be predicted by the Company at this time, including, among others, the future market price of the Common Stock. This presentation is not intended to constitute a prediction as to the future market price of the Common Stock or as to the number of shares of Common Stock issuable under the financing arrangement. See "Risk Factors -- Dilution"; and "Description of Securities."

The Company's executive offices are located at 12701 Fair Lakes Circle, Fairfax, Virginia 22033 and its telephone number is (703) 631-6925.

THE SECURITIES OFFERED HEREBY INVOLVE A HIGH DEGREE OF RISK AND PROSPECTIVE PURCHASERS SHOULD CAREFULLY CONSIDER THE FACTORS SPECIFIED UNDER THE CAPTION "RISK FACTORS" LOCATED ON PAGE 8 OF THIS PROSPECTUS.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF

COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE DATE OF THIS PROSPECTUS IS _____, 1998

ADDITIONAL INFORMATION

The Company has filed with the Securities and Exchange Commission (the "Commission"), Washington, D.C., a Registration Statement on Form SB-2 under the Securities Act of 1933, as amended, with respect to the securities offered hereby. This Prospectus does not contain all of the information set forth in such Registration Statement and the exhibits thereto. For further information with respect to the Company and the Shares, reference is hereby made to the Registration Statement, exhibits and schedules which may be inspected without charge at the public reference facilities maintained at the principal office of the Commission at 450 Fifth Street, N.W., Room 1024, Washington D.C. 20549 and at the Commission's regional offices at 7 World Trade Center, New York, New York 10048 and Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such materials may be obtained upon written request from the public reference section of the Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. Electronic registration statements made through the Electronic Data Gathering, Analysis, and Retrieval System are publicly available through the Commission's Web site (<http://www.sec.gov>). Statements contained in the Prospectus as to the contents of any contract or other document referred to herein are not necessarily

complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement, each such statement being qualified in all respects by such reference.

The Company is subject to the informational requirements of the Securities Exchange Act of 1934 and, in accordance therewith, files reports and other information with the Commission. Such reports and other information filed by the Company may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, and at the following Regional Offices of the Commission: New York Regional Office, Seven World Trade Center, 13th Floor, New York, New York 10048; and Chicago Regional Office, Northwest Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661-2511. Copies of such material can be obtained from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The Commission maintains a Web site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding registrants that file electronically. Reports and other information concerning the Company may also be inspected at the offices of the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006.

This Prospectus contains certain statements concerning the Company's future results, future performance, intentions, objectives, plans and expectations that are or may be deemed to be "forward-looking statements". The Company's ability to do this has been fostered by the Private Securities Litigation Reform Act of 1995 which provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information so long as those statements are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statement. The Company believes it is in the best interests of investors to take advantage of the "safe harbor" provisions of that Act. Such forward-looking statements are subject to a number of known and unknown risks and uncertainties that, in addition to general economic and business conditions, could cause the Company's actual results, performance, and achievements to differ materially from those described or implied in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the Company's ability to profit from the Mobile Assistant(R) as expected (see "Products and Product Development"), the Company's ability to meet competition (see "Competition"), the Company's ability to maintain superior technological capability, foreseeing changes and continuing to identify, develop and commercialize innovative and competitive products and systems (see "Research and Development"), the Company's ability to penetrate different markets and successfully expand its market base (see "Marketing and Sales"), the Company's ability to attract and retain technologically qualified personnel, particularly in the areas of research and development (see "Employees"), and the Company's ability to generate cash flows and obtain financing to support its operations and growth (see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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PROSPECTUS SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial statements and notes thereto appearing elsewhere or incorporated by reference in this Prospectus.

To inform investors of the Company's future plans and objectives, this Prospectus (and other reports and statements issued by the Company and its officers from time to time) contain certain statements concerning the Company's future results, future performance, intentions, objectives, plans and expectations that are or may be deemed to be "forward-looking statements." The Company's ability to do this has been fostered by the Private Securities Litigation Reform Act of 1995 (the "Reform Act"), which provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information so long as those statements are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statement. The Company believes it is in the best interest of investors to take advantage of the "safe harbor" provisions of the Reform Act. Such forward-looking statements are subject to a number of known and unknown risks and uncertainties that, in addition to general economic and business conditions and those described in "Risk Factors" could cause the Company's actual results, performance and achievements to differ materially from those described or implied in the forward-looking statements.

The Company

Xybernaut Corporation, a Delaware corporation (the "Company"), is engaged in the research, development and commercialization of mobile computer systems and related software solutions designed to enhance personal productivity, especially in commercial, industrial and military applications. The Company's current mobile computing product is the Mobile Assistant(R) 133P

model, which is a full-function, body-worn, voice-controlled 133 MHZ Pentium(R) computer with a head-mounted video display ("133P"). The Company has begun production of its next-generation MMX Pentium(R) Mobile Assistant(R) ("MA IV"). With the speed, memory, processing, multimedia and communication capabilities of a desktop personal computer ("PC") in a lightweight unit, the Mobile Assistant(R) Series combines full-function PC features with hands-free operation and simultaneous user mobility. The Mobile Assistant(R) is a combination of hardware and software specifically designed for body-worn mobile computing (the "Mobile Assistant(R) Series"). The Mobile Assistant(R) Series with application software is designed to allow workers with minimal training to perform complex and time consuming tasks such as maintenance, repair and inspection of complex technological and mechanical systems, retrieval and analysis of medical information from remote locations, and coordination of remote commercial and industrial activities and military field operations, in a more efficient manner than current technology allows. Purchasers of the Mobile Assistant(R) Series have included, among others, AT&T, Lucent, NTT (Nippon Telegraph and Telephone), Eaton Corporation, Fujitsu, Battelle Memorial Institute, Shell Oil, Mitsubishi, Rockwell International, Lockheed Martin, and the United States Army and Navy. In March 1996, Rockwell International, which manufactured the computing unit utilized in the Mobile Assistant I(R), licensed from the Company the right to manufacture and market mobile computers utilizing certain intellectual property and related technical know-how which has been developed by the Company.

The Mobile Assistant(R) Series can utilize technologically advanced features such as real time two-way video and audio communications through radio frequency transmissions, integrated cellular linkups, global positioning system tracking capabilities and access to information through the Internet and World Wide Web. The new head-mounted display unit ("HMD") includes a two-way audio system and optional built-in video camera, weighs approximately 15 ounces and presents a desk-top quality full VGA color image that is approximately equivalent to that of a 15" VGA monitor at a distance of approximately two feet. An optional light-weight, 6.4 inch, full VGA color, flat panel display ("FPD"), with integrated digitizer, is offered for users who do not desire an HMD or do not need to be 100% hands-free and feet-free to perform their job. The body-worn computing unit is designed to allow operation in environmental conditions in which conventional portable computers could not previously operate, weighs less than two pounds and is capable of running software

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applications designed for Microsoft(R) Windows(R) 3.11, Windows(R) 95 and 98, Windows(R) NT(TM), DOS, SCO UNIX(R) and LINUX.

The Company offers novel software products, to get user documentation up and running on the Mobile Assistant quickly, that can be used on the Mobile Assistant(R) or conventional desktop or laptop computers. The following two products are available now with others under development. The Company's linkAssist(TM) software allows users to develop applications that need for information to be quickly and easily linked together regardless of the format of the data or where it is stored, avoiding the need to change, convert or reenter the existing information or to use the very technical HTML tagging process. An interesting and useful feature of this product is that the linked words or phrases can then be activated by voice automatically, with no development work by the author of the documentation or databases. The webAssist(TM) software offered by the Company allows voice navigation of HTML document links such as those found on web sites on the World Wide Web and intranets. This provides the user with hands-free access to all of the information found on, for example, manufacturer and supplier and company-owned, web sites.

The Company was incorporated in Virginia as Contemporary Products & Services, Inc. in November 1990 and changed its name to Computer Products & Services, Inc. in November 1992. In April 1996 the Company merged with Xybernaut Corporation, a Delaware corporation, in order to change its name and reincorporate in Delaware.

The Company's executive and administrative offices are located at 12701 Fair Lakes Circle, Fairfax, Virginia 22033. Its telephone number is (703) 631-6925, and its e-mail address is investrel@xybernaut.com.

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The Offering

Securities Offered by the Company.....	2,100,000 Shares of Common Stock
Securities Offered by the Selling Stockholder..	2,100,000 Shares of Common Stock
Common Stock Outstanding:	
Before the Offering (1).....	20,958,506

After the Offering (1).....	23,058,506
Nasdaq Symbol.....	XYBR
Use of Proceeds.....	The Company will not receive any proceeds from the resale of the Shares by the Selling Stockholder. However, the Company will receive proceeds from the draw downs, the Call Options, if any, and the exercise of the warrants issued pursuant to the Financing Agreement and will use such proceeds for general corporate purposes. See "Use of Proceeds."
Risk Factors.....	An investment in the securities offered hereby involves a high degree of risk and immediate substantial dilution to public investors. See "Risk Factors."

(1) Based on shares of Common Stock outstanding at September 24, 1998, and does not include (i) 1,234,550 shares of Common Stock reserved for issuance upon the exercise of outstanding options granted pursuant to Rule 701 of the Securities Act, the Company's 1996 Omnibus Stock Incentive Plan and the 1997 Stock Incentive Plan; (ii) 5,173,402 shares of Common Stock reserved for issuance upon exercise of outstanding warrants to purchase Common Stock, (iii) 141,700 shares of Common Stock registered in connection with the Series C Preferred Stock but unissued, (iv) 595,360 shares of Common Stock registered in connection with the April 1998 Private Equity Line of Credit Private Placement but unissued, and (v) 420,000 shares of Common Stock reserved for issuance upon exercise of an option granted pursuant to the Company's IPO to purchase 210,000 shares of Common Stock and 210,000 redeemable warrants, each such warrant to purchase one share of Common Stock at an exercise price of \$9.075. See "Risk Factors -- Effect of Possible Non-Cash Future Charge" and "-- Securities Issuable Pursuant to Options, Warrants and the Unit Purchase Option."

RISK FACTORS

An investment in the shares of Common Stock offered hereby involves a high degree of risk. Prospective investors should carefully consider the following risk factors, in addition to the other information set forth in this Prospectus, in connection with an investment in the shares of Common Stock offered hereby.

History and Expectation of Future Losses

The Company was incorporated in October 1990 and commenced operations in November 1992. In the fiscal years ended March 31, 1994 and 1995, the Company incurred a net loss of \$47,352 and \$1,303,892, respectively. In the years ended December 31, 1996 and 1997, the Company incurred a net loss of \$5,238,536 and \$9,479,966, respectively. For the six months ended June 30, 1998, the Company incurred a loss of \$3,792,505. The Company intends to conduct significant additional marketing and distribution of its products that, together with existing research and development programs, are expected to require substantial funding and to result in continuing operating losses until such time as sufficient gross margins from revenues are generated to cover operating costs. Management of the Company believes that as long as the Financing Arrangement is in effect, the Company will not need additional financing in order to carry out its programs. There can be no assurance that, notwithstanding these efforts and the expenditure of substantial funds, the Company ever will achieve substantial sales of any of its products or profitable operations or that it will be able to meet the competitive demands of the industry in which it operates. The success of the Company will be affected by expenses, operational difficulties and other factors frequently encountered in the development of a business enterprise in a competitive environment, many of which may be beyond the Company's control. See "Risk Factors - Competition."

Going Concern Qualification

The report of the Company's independent accountants contains an explanatory paragraph as to the Company's ability to continue as a going concern. Among the factors cited by the independent accountants as raising substantial doubt as to the Company's ability to continue as a going concern is that the Company has incurred losses since inception and has a working capital deficit. There can be no assurance that the Company will ever achieve significant revenues or profitable operations. See "Management's Discussion and

Liquidity; Working Capital Needs

To meet working capital cash requirements, the Company may obtain a working capital line of credit and/or complete additional financings including the sale of up to \$31,200,000 of the Company's Common Stock over a period of twelve months under the Financing Arrangement with the investor and up to an additional \$31,200,000 of the Company's Common Stock in the event that the investor exercises a Call Option. To fully utilize the Financing Arrangement, the Company may need to register additional shares of Common Stock. There can be no assurance that the Company can or will obtain sufficient funds to meet, in whole or in part, its working capital needs from collections of product sales. In the event the Financing Arrangement is terminated and funding thereunder is not available, the Company may exercise a put option to sell shares of Common Stock in the aggregate principal amount of \$7,000,000 pursuant to an April 1998 Private Equity Line of Credit Agreement among the Company and several investors. There can be no assurance that the Company will be capable of raising additional capital thereafter or of establishing and obtaining funds from a working capital line of credit, that the sale of shares of Common Stock by the Company under its Private Equity Line of Credit Agreement and its Financing Arrangement will be deemed advisable at such times as funds may be required, or that the terms upon which such capital or line of credit would be available to the Company would be acceptable, in which case the Company could be required to curtail materially, suspend or cease operations.

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Dilution; Impact of Sale of Common Stock Upon Conversion of Outstanding Options, Redeemable Warrants, the Unit Purchase Option and Certain Repricing Options

The purchasers of the Shares offered hereby will experience immediate and substantial dilution in the net tangible value of their Shares in the event of the continuous sale of Common Stock by the Company under the Financing Arrangement with the Selling Stockholder, the conversion of outstanding options, warrants and the issuance of shares of Common Stock pursuant to certain repricing arrangements entered into by the Company in connection with its exercise of a \$3,000,000 Put Option under the April 1998 Private Equity Line of Credit Agreement (the "Initial Put Option"). Specifically, certain options and warrants (other than the Warrants) are convertible into Common Stock at discounts from future market prices of the Common Stock, which could result in substantial dilution to existing holders of Common Stock. The sale of such Common Stock acquired at a discount could have a negative impact on the trading price of the Common Stock and could increase the volatility in the trading price of the Common Stock.

At the date of this Prospectus, the Company has reserved an aggregate of 6,827,952 shares of Common Stock for issuance on exercise of outstanding options and warrants. The exercise price of the options presently outstanding is between \$1.37 and \$6.00 for 1,234,550 shares granted from April 1, 1995 to September 24, 1998. The exercise price of the 590,000 warrants outstanding as of September 24, 1998 is between \$1.76 and \$18.00 per share. In connection with the Company's IPO, warrants to purchase 3,846,429 shares were originally issued that entitle the holders thereof to purchase a share of common stock for \$9.00 until July 17, 1999. These warrants contain anti-dilution provisions that have resulted in the number of shares to be issued upon a complete warrant exercise increasing to 4,583,402. At the completion of the IPO, the underwriter received an option (the "Unit Purchase Option") to purchase 210,000 Units (the "Units"), each unit consisting of one share of Common Stock and one Redeemable Warrant (a "Redeemable Warrant") to purchase one share of Common Stock, at a price of \$9.075 per Unit during a period of four years commencing July 18, 1996. The Redeemable Warrants included in the Unit Purchase Option are exercisable at \$12.60 per share. During the terms of the outstanding options, Redeemable Warrants and the Unit Purchase Option, the holders are given the opportunity to profit from a rise in the market price of the Common Stock, and their exercise may dilute the ownership interest of existing stockholders, including investors in this offering. The existence of the options, the Redeemable Warrants and the Unit Purchase Option may adversely affect the terms on which the Company may obtain additional equity financing. Moreover, the holders are likely to exercise their rights to acquire Common Stock at a time when the Company would otherwise be able to obtain capital on terms more favorable than could be obtained through the exercise of such securities.

In addition, the Company agreed to certain repricing arrangements in connection with its exercise of the Initial Put Option. Pursuant to such arrangement, one-sixth of the 545,454 shares of Common Stock (the "Initial Put Shares") issued upon exercise of the Initial Put Option, are subject to monthly repricing commencing on September 30, 1998. Under the repricing calculation, if the closing price of the Common Stock on the trading date immediately preceding the repricing date is less than \$7.20 per share, the shares of Common Stock subject to repricing shall be repriced at the lowest closing bid price of the

Common Stock for the 30 days preceding such repricing date (the "Initial Put Reset Price"). The Company shall issue to the investors such number of shares (the "Initial Put Repricing Shares") equal to the difference between (a) the quotient of 500,000 and the Initial Put Reset Price and (b) the number of shares subject to repricing. No additional shares of Common Stock shall be issued if the Initial Put Reset Price is equal to or greater than \$5.50.

Uncertainty of Completion of the Investment

Pursuant to the terms of a Subscription Agreement between the Company and HSBC James Capel Canada, Inc. ("HSBC"), the Company, at its option, may issue up to a total of \$31,200,000 million of Common Stock over a twelve month period. The Financing Arrangement provides however that if the purchase price of the Common Stock at the time of the draw down is less than \$3.00, HSBC will not be required to fund a draw down. On September 24, 1998, the closing bid price for a share of Common Stock as quoted on the NASDAQ SmallCap Market was \$5.4375. There can be no assurances that the closing bid price for a share of Common

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Stock will equal or exceed \$3.00 in the future. If a draw down is not completed, the Company will receive significantly less proceeds than is estimated in this Prospectus. See "Financing Arrangement." As a result, the financial condition and results of operations of the Company could be materially adversely affected.

Uncertainty of Market Development and Product Acceptance

The mobile computing market is emerging and relatively undeveloped. The Company sold its first Mobile Assistant(R) in 1993 and from December 31, 1997 through June 30, 1998 had sold and delivered Mobile Assistant(R) systems valued at approximately \$357,000. The Company commenced delivery of the Pentium(R) Mobile Assistant P-133(TM) in August 1997 and has announced that it will commence delivery of Mobile Assistant(R) IV, a Pentium 233 MHZ based system ("MA IV"), in the quarter ending December 31, 1998. In September 1997, the Company announced linkAssist(TM), a software development toolkit, which provides speech linking of data in almost any format, without altering the original data and webAssist(TM) software that allows voice navigation of HTML links found on the Internet and intranet. The size of the mobile computing market is currently limited by the high unit prices of mobile computers as compared to laptops and other portable computers, the specialized nature of each application and the need for custom applications and system integration and the limited supply to date of components for completed systems. The potential size of the market will be limited by the rate at which prospective customers recognize and accept the functions and capabilities of integrated mobile computing systems. There can be no assurance that a significant market will develop for mobile computing systems or, if a market develops, that the Mobile Assistant(R) series and any of the Company's other products will become a significant factor in any market that develops. In addition, there is no assurance that the Company will obtain the working capital needed to meet the competitive demands of the industry in which it operates. See "Risk Factors - Liquidity; Working Capital Needs; -- Competition."

The commercial success of the Mobile Assistant(R) series, linkAssist(TM), webAssist(TM) and software toolkits enabling the Company's customers to more rapidly create customized software applications on a stand-alone basis or for use with the Mobile Assistant(R) series, and any other product that the Company may develop will depend upon acceptance by the commercial, healthcare, education and military markets, of which there can be no assurance.

The Company believes that any product acceptance will be substantially dependent upon educating the commercial, healthcare, education and military markets as to the capabilities, characteristics, benefits and efficacy of the Mobile Assistant(R) series and the Company's other products, of which there can be no assurance.

Competition

The computer industry is intensely competitive and is characterized by rapid technological advances, evolving industry standards and technological obsolescence. Many of the Company's current competitors have longer operating histories and greater financial, technical, sales, marketing and other resources than the Company. Several other companies are engaged in the manufacture and development of body-mounted or hand-held computing systems that compete with the Mobile Assistant(R) series, including Computing Devices International, a division of Ceridian Corporation, ViA Inc., Texas Microsystems, Telxon, Norand and Teltronics, Inc., a subsidiary of Interactive Solutions, Inc., Raytheon and a consortium of Litton and TRW. Personal digital assistants and laptop and notebook computers also are products that could compete against the Mobile Assistant(R) in applications where hands-free, voice-activated operation is not required. Many of these computers are manufactured by major domestic and foreign

computer manufacturers which possess far more resources than the Company and can be expected to compete vigorously with the Company for the market at which the Mobile Assistant(R) is directed. In addition, new and competing technologies are being developed in hands-free mobile computing systems. There can be no assurance that the Company will be able to compete successfully against its competitors, that it will have the working capital needed to incorporate the constant technological advances in its products or that the competitive pressures faced by the Company will not adversely affect its financial performance.

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Dependence upon Suppliers

The Company has entered into supplier relationships with Sony Digital Products and Shimadzu, among others, for the production of the MA IV system. The Company has also entered into written agreements with its suppliers for batteries, head-mounted displays and computing units. Although the Company believes there are multiple sources for many parts and components, the Company currently depends heavily on its current suppliers. Although management believes that the Company could adapt to any supply interruptions, such occurrences could necessitate changes in product design or assembly methods for the Mobile Assistant(R) series and cause the Company to experience temporary delays or interruptions in supply while such changes are incorporated. Further, because the order time for certain components may range up to approximately three months, the Company also could experience delays or interruptions in supply in the event the Company is required to find a new supplier for any of these components. Any disruptions in supply of necessary parts and components from the Company's key suppliers could have a material adverse effect on the Company's results of operations. Any future shortage or limited allocation of components for the Mobile Assistant(R) could have a material adverse effect on the Company.

Currency Fluctuations

Exchange rates for some local currencies in countries where the Company operates may fluctuate in relation to the U.S. dollar and such fluctuations may have an adverse effect on the Company's expenses, earnings or assets when local currencies are translated into U.S. dollars. The Company has entered into a supplier arrangement with Sony Digital Products for the production of the MA IV system. The fees payable to Sony Digital Products are paid in Japanese yen. Any weakening of the value of the U.S. dollar against the Japanese yen could result in higher production expenses for the Company when U.S. dollars are translated into Japanese yen. Therefore, there can be no assurance that currency exchange rates will not have a material adverse effect on the Company.

Substantial Dependence upon Single Product Line; Possibility of Unsuccessful New Product Development

The Mobile Assistant(R) series currently consists of the MA IV, which is expected to be available for sale in late 1998, and the P-133 model based on a 133 MHZ Intel Pentium(R) processor. The Mobile Assistant(R) series are the Company's principal products, and its success will depend upon its commercial acceptance, which cannot be assured. For single unit purchases, the Mobile Assistant(R) P-133 currently is priced from \$5,000 to \$8,995 depending upon the discount and selected features. As technological developments cause declines in hardware costs, the Company expects that mobile computer sales will be driven by system capabilities and integration. There is no assurance that the Mobile Assistant(R) will offer the performance capabilities or features that customers will value and, if not, the Company could be required to modify the design of the Mobile Assistant(R) which may require the expenditure of additional capital currently available to the Company. While linkAssist(TM) and the Company's planned software toolkits are intended for use both with the Mobile Assistant(R) series and independently, there can be no assurance that a separate market for the Company's existing and planned software products will develop. There can be no assurance that any products, if sold, will generate significant revenues or any profits. The Company is also developing additional products for the Mobile Assistant(R) series for introduction in the future and intends to modify the Mobile Assistant(R) series for use in other applications and to develop other products using its core technologies. Additional product development will result in the Company incurring significant research and development expenses that may be unrecoverable should commercialization of new products prove unsuccessful. The Company also could require additional funding if research and development expenses are greater than anticipated. There can be no assurance that the Company will be successful in its future product development efforts or in diversifying its product line. See "Risk Factors Liquidity; Working Capital Needs."

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Uncertain Protection of Patent and Proprietary Rights;
No Assurance of Enforceability or Significant Competitive Advantage

The Company considers its patent, trade secrets, and other intellectual property and proprietary information to be important to its business prospects. The Company relies on a combination of patent, trade secret, copyright and trademark laws and contractual restrictions to establish and protect its proprietary rights. The Company has entered into confidentiality and invention assignment agreements with its employees, and enters into non-disclosure agreements with its suppliers, VARs, OEMs and actual and potential customers to limit access to and disclosure of its proprietary information. The Company has registered its Mobile Assistant(R) and Xybernaut(R) trademarks on the Principal Register of the United States Patent and Trademark Office ("Patent Office") and the patent and trademark offices in several foreign countries.

In April 1994, U.S. patent number 5,305,244 ("hands-free, user-supported portable computers") (the "Patent") for the Mobile Assistant(R) Series was granted to the Company. This patent was previously assigned to the Company by several employees of the Company. In September 1995 and April 1996, the Company received separate reexamination notifications from the Patent Office, which reexaminations of the Patent were initiated as a result of a request from one of the Company's competitors. In November 1996, the Company filed a written response to the request for reexamination and preliminary rejection. The second re-examination has been concluded and the Patent Office indicated that the Company was successful in the reexamination and sent the Company a "Notice of Intent to Issue Reexamination Certificate" indicating that the Patent Office ruled in the Company's favor. Subsequently on September 23, 1997, the Patent Office issued the Reexamination Certificate to the Company indicating successful results for the Company in the second re-examination. Most of the Company's revenue for the twelve months ended December 31, 1997 and 1996 and the six months ended June 30, 1998 and 1997 were derived from products included within the scope of the patent. The Company has notified several of its competitors of the existence of the Patent, which the Company's counsel believes may have been infringed by some of such competitors. The Company intends to take any and all appropriate measures, including legal action, necessary to maintain and enforce its rights under the Patent and other patents held by the Company and to recover any damages suffered as a result of any alleged infringement.

Since July 1996, the Company has filed twenty patent applications covering various aspects of computers in general and wearable computers in particular. Of these twenty applications, six additional patents have been issued, one patent has been allowed pending issuance and thirteen patents are pending. Most of these applications have also been filed in European countries, The People's Republic of China, Japan, Republic of Korea, Republic of China (Taiwan), Canada and Australia. All patents obtained by Company employees under pending and future applications have been and will be assigned to the Company under existing invention assignments.

Notwithstanding the foregoing, there can be no assurance that the Company's pending patent applications will issue as patents, that any issued patent will provide the Company with significant competitive advantages or that challenges will not be instituted against the validity or enforceability of any patent held by the Company.

The cost of litigation to uphold the validity and prevent infringement of patents can be substantial. There also can be no assurance that others will not independently develop similar or more advanced products, design patentable alternatives to the Company's products or duplicate the Company's trade secrets. The Company may in some cases be required to obtain licenses from third-parties or to redesign its products or processes to avoid infringement. The Company also relies on trade secrets and proprietary technology and enters into confidentiality agreements with its employees and consultants. The Company has implemented a trade secret management program to further protect its trade secrets and proprietary information. There can be no assurance that the obligation to maintain the confidentiality of such trade secrets or proprietary information will not be breached by employees or consultants or that the Company's trade secrets or proprietary technology will not otherwise become known or be independently developed by competitors in such a manner that the Company has no practical recourse.

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Dependence upon and Need for Key Personnel

The Company's success depends to a significant extent upon the efforts of senior management personnel and a group of employees with longstanding industry relationships and technical knowledge of the Company's business and operations. The loss of certain key members of senior management and the inability to replace such member could have a material adverse effect on the Company's business and operations. The Company's success also will depend upon its ability to attract and retain highly qualified and experienced management and technical personnel. The Company faces competition for such personnel from

numerous other entities, many of which have significantly greater resources than the Company. There can be no assurance that the Company will be successful in recruiting such personnel or that, if recruited, such persons would succeed in establishing profitable operations for the Company.

Rapid Technological Change and Risk of Obsolescence

The market for computer products is characterized by rapid technological advances, evolving industry standards, changes in end user requirements and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards could render the Company's existing products and products currently under development obsolete and unmarketable. The Company's success will depend upon its ability to enhance its current products and develop and successfully introduce and sell new products that keep pace with technological developments and respond to evolving end user requirements. Any failure by the Company to anticipate or respond adequately to technological developments or end user requirements, or any significant delays in product development or introduction, could damage the Company's competitive position in the marketplace and reduce revenues. The Company expects to increase the use of additional external and internal resources in the near term to meet these challenges. There can be no assurance that the Company will be successful in hiring, training and retaining qualified product development personnel to meet its needs. There can be no assurance that the Company will be successful in developing and marketing new products or product enhancements on a timely basis. Any failure to successfully develop and market new products and product enhancements would have a material adverse effect on the Company's results of operations.

Year 2000 Issues

The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

Based on a recent assessment, the Company determined that it will be required to modify or replace portions of its software so that its computer systems will properly utilize dates beyond December 31, 1999. The Company presently believes that with modifications to existing software and conversions to new software, the Year 2000 Issue can be mitigated. However, if such modifications and conversions are not made, or are not completed timely, the Year 2000 Issue could have a material impact on the operations of the Company.

The Company has initiated formal communications with all of its significant suppliers and large customers to determine the extent to which the Company is vulnerable to those third parties' failure to remediate their own Year 2000 Issue. The Company's total Year 2000 project cost and estimates to complete include the estimated costs and time associated with the impact of a third party's Year 2000 Issue, and are based on presently available information. However, there can be no guarantee that the systems of other companies on which the Company's systems rely will be timely converted, or that a failure to convert by another company, or a conversion that is incompatible with the Company's systems, would not have material adverse effect on the Company. The Company has determined it has no exposure to contingencies related to the Year 2000 Issue for the products it has sold.

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The Company will utilize both internal and external resources to reprogram, or replace, and test the software for Year 2000 modifications. The Company plans to complete the Year 2000 project within six months. The total remaining cost of the Year 2000 project is estimated at \$6,000. Of the total project cost, approximately \$1,700 is attributable to the purchase of new software which will be capitalized. The remaining \$4,300, which will be expensed as incurred over the next six months, is not expected to have a material effect on the results of operations. To date, the Company has incurred and expensed approximately \$1,000 related to the assessment of, and preliminary efforts in connection with, its Year 2000 project and the development of a remediation plan.

The costs of the project and the date on which the Company plans to complete the Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events including the continued availability of certain resources, third party modification plans and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those plans. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties.

As a condition to the Company's initial public offering (the "IPO"), certain of the Company's stockholders, primarily officers and directors, have been required to deposit an aggregate of 1,800,000 shares of Common Stock into an escrow account (the "Escrowed Shares"). The Escrowed Shares are subject to incremental release over a three-year period only in the event the Company's gross revenues and earnings (loss) per share for the 12-month periods ending September 30, 1997, 1998 and 1999 equal or exceed certain gross revenue and earnings (loss) per share targets. If such per share targets are not met in any of the relevant 12-month periods (and the price of the Common Stock does not meet or exceed the price described below), certain agreed upon amounts of the Escrowed Shares will be returned to the Company for each period and canceled. In addition to the foregoing, all the then Escrowed Shares will be released to the stockholders if the closing price of the Common Stock as reported on The Nasdaq SmallCap Market following this offering equals or exceeds \$11.00 for 25 consecutive trading days or 30 out of 35 consecutive trading days during the period ending September 30, 1999. In the event any Escrowed Shares held by officers, employees and consultants are released, the difference between the initial offering price and the market value of such shares at the time of release will be deemed to be additional compensation expense to the Company which, depending on the price per share, may have the effect of reducing or eliminating any earnings per share and could have a negative effect on the market price for the Common Stock. The stock and earnings targets for escrow release for September 30, 1997 were not achieved and 300,000 shares were canceled from the escrow pool, which resulted in a reduction of 2.1% of the Company's outstanding shares of Common Stock. Given the expenditures related to the start of full-scale production of the MA IV in the quarter ending December 31, 1998, the Company's management believes that it is likely that the Company's gross revenues and allowable losses will not meet the Performance Targets for the 12-month period ending September 30, 1998 thereby resulting in 750,000 shares of stock being canceled from the escrow pool, which will result in a reduction of 3.6% of the Company's outstanding shares of Common Stock.

High Concentration of Common Stock Held by Existing Stockholders

Following this offering, the Company's executive officers, directors and principal stockholders will, in the aggregate, beneficially own approximately 29.3% of the Company's outstanding shares of Common Stock. These stockholders, if acting together, will be able to effectively control most matters requiring approval by the stockholders of the Company, including the election of directors. The voting power of these stockholders under certain circumstances could have the effect of delaying or preventing a change in control of the Company.

Limitation of Liability

The Company's Certificate of Incorporation provides that directors of the Company shall not be personally liable for monetary damages to the Company or its stockholders for a breach of fiduciary duty as a

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director, subject to limited exceptions. Although such limitation of liability does not affect the availability of equitable remedies such as injunctive relief or rescission, these provisions of the Certificate of Incorporation could prevent the recovery of monetary damages against directors of the Company. See "Indemnification for Securities Act Liabilities."

Shares Eligible for Future Sale

Sales of a substantial number of shares of the Company's Common Stock in the public market following this offering could adversely affect the market price of the Common Stock. Of the 24,155,566 shares of Common Stock that will be outstanding or registered for sale upon the completion of this offering, 22,391,426 will be freely tradeable without restriction or further registration under the Securities Act. This includes 19,194,366 shares of Common Stock which are issued and outstanding, 141,700 unissued shares of Common Stock registered in connection with the Series C Preferred Stock, 955,360 unissued shares of Common Stock registered in connection with the April 1998 Equity Line of Credit Private Placement and the 2,100,000 unissued shares of Common Stock registered in connection with the Financing Arrangement. The remaining 1,764,140 shares include 1,500,000 shares of Common Stock which are "Escrowed Shares" (see "Executive Compensation -- Escrowed Shares") and are subject to incremental release over a two-year period if certain share targets are met, and 264,140 shares of the Common Stock are "restricted securities" as that term is defined in Rule 144 promulgated under the Securities Act, and in the future may only be sold pursuant to an effective registration statement under the Securities Act, in compliance with the exemption provisions of Rule 144 or pursuant to another exemption under the Securities Act. In the absence of any agreement to the contrary, the outstanding restricted Common Stock could be sold in accordance with one or more other exemptions under the Securities Act (including Rule 144).

Rule 144, as amended, permits sales of restricted securities by any person (whether or not an affiliate) after one year, at which time sales can be made subject to the Rule's existing volume and other limitations and by non-affiliates without adhering to Rule 144's existing volume or other limitations after two years. Future sales of substantial amounts of shares in the public market, or the perception that such sales could occur, could adversely affect the price of the shares in any market that may develop for the trading of such shares.

No Dividends Anticipated

The Company has never paid any dividends on its securities and does not anticipate the payment of dividends in the foreseeable future.

Volatility of Stock Price

The trading price of the Common Stock has been volatile, and it may continue to be so. Such trading price could be subject to wide fluctuations in response to announcements of business and technical developments by the Company or its competitors, quarterly variations in operating results, and other events or factors, including expectations by investors and securities analysts and the Company's prospects. In addition, stock markets have experienced extreme price volatility in recent years. This volatility has had a substantial effect on the market prices of development stage companies, at times for reasons unrelated to their operating performance. Such broad market fluctuations may adversely affect the price of the Common Stock.

Anti-takeover Consideration; Rights of Preferred Stock

The Company's Certificate of Incorporation authorizes the issuance of up to 6,000,000 shares of \$.01 par value preferred stock (the "Preferred Stock"). As of the date of this Prospectus, only the Series C Preferred Stock are issued and outstanding. The authorized and unissued Preferred Stock may be issued with voting, conversion or other terms determined by the Board of Directors which could be used to delay, discourage or prevent a change of control of the Company. Such terms could include, among other things, dividend payment requirements, redemption provisions, preferences as to dividends and distributions and preferential voting rights. The issuance of Preferred Stock with such rights could have the effect of limiting stockholder participation in certain transactions such as mergers or tender offers and could discourage or prevent a change in management

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of the Company. The Company has no present intention to issue any additional Preferred Stock. See "Description of Securities -- Preferred Stock."

The Board of Directors has a classified or staggered Board of Directors which limits an outsider's ability to effect a rapid change of control of the Board. In addition, at the upcoming annual meeting of stockholders of the Company to be held on September 24, 1998, the shareholders of the Company will vote on proposed measures to amend the Company's Certificate of Incorporation and By-laws, where applicable, to (i) implement an advance notice procedure for the submission of director nominations and other business to be considered at annual meetings of stockholders; (ii) permit only the President, the Vice Chairmen of the Board, the Secretary or the Board of Directors to call special meetings of stockholders and to limit the business permitted to be conducted at such meetings to be brought before the meetings by or at the direction of the Board of Directors; (iii) provide that a member of the Board of Directors may only be removed by the stockholders of the Company for cause by an affirmative vote of holders of at least 66 2/3% of the voting power of the then outstanding shares of any class or series of capital stock of the Company entitled to vote generally in the election of directors voting together as a single class (the "Voting Stock"); (iv) fix the size of the Board of Directors at a maximum of twelve directors, with the authorized number of directors set at ten, and the Board of Directors having the sole power and authority to increase or decrease the number of directors acting by an affirmative vote of at least a majority of the total number of authorized directors most recently fixed by the Board of Directors; (v) provide that any vacancy on the Board of Directors may be filled for the unexpired term (or for a new term in the case of an increase in the size of the board) only by an affirmative vote of at least a majority of the remaining directors then in office even if less than a quorum, or by the sole remaining director; (vi) eliminate stockholder action by written consent; (vii) require the approval of holders of 80% of the then outstanding Voting Stock and/or the approval of 66 2/3% of the directors of the Company for certain corporate transactions; and (viii) require an affirmative vote of 66 2/3% of the Voting Stock in order to amend or repeal any adopted amendments to the Certificate of Incorporation and Bylaws adopted at the meeting.

Such measures, if adopted, in addition to the existing ability of the Board of Directors to issue "blank check" Preferred Stock and the staggered

Board of Directors could have the effect of delaying, deterring or preventing a change in control of the Company without any further action by the shareholders. In addition, issuance of Preferred Stock, without shareholder approval, on such terms as the Board of Directors may determine, could adversely affect the voting power of the holders of the Common Stock, including the loss of voting control to others. See "Description of Securities."

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FINANCING ARRANGEMENT

Pursuant to the Subscription Agreement between the Company and HSBC James Capel Canada, Inc. (the "Selling Stockholder" or "HSBC"), HSBC will purchase, at the Company's request, up to \$31,200,000 of Common Stock of the Company during the twelve month period following the initial draw down.

Pursuant to the terms of the Subscription Agreement, immediately following the effective date of the Registration Statement of which this Prospectus is an integral part, the Company, at its option, may present the Selling Stockholder with a weekly, monthly or quarterly draw down request for the purchase of up to \$600,000, \$2,400,000 and \$7,200,000, respectively, of the Company's Common Stock (each request a "Draw Down Request") during the twelve month period commencing on the date of the initial draw down. The purchase price of such shares shall be equal to the lesser of (i) 100% of the average of the daily volume weighted average price of the Common Stock on NASDAQ SmallCap Market as reported by Bloomberg Financial using the AQR function for a certain number of consecutive trading days preceding the draw down payment date and (ii) \$8.00; provided, however, that if the purchase price is less than \$3.00 the Selling Stockholder will not be required to fund such draw down.

The Company will set the lowest price at which it will issue its shares under the Financing Arrangement (the "Threshold Price"). The Threshold Price may not be set below \$3.00. If the average daily price on a given trading day is less than the Threshold Price then HSBC's payment obligation under the draw down will be reduced by 1/5th, 1/20th or an agreed upon fraction for a weekly, monthly or quarterly draw down, respectively.

Upon acceptance of the Company's draw down Request, the Selling Stockholder, at its option, may purchase an additional amount of Common Stock up to the maximum amount of each draw down at a price per share equal to the daily volume weighted average price of the Company's Common Stock on the NASDAQ Small Cap Market as reported by Bloomberg Financial using the AQR function on the date the Company furnishes the Selling Stockholder with a Draw Down Request. The Selling Stockholder's right to purchase additional shares of the Company may be exercised only with respect to each Draw Down Request and is waived for the period it remains unexercised.

In addition, for each draw down, the Selling Stockholder will receive a Warrant to purchase 12,500, 50,000 and 150,000 shares of Common Stock for each weekly, monthly and quarterly draw down, respectively. Each Warrant will have a three-year exercise period commencing six months from the funding date of the draw down. The exercise price of the warrants is 225% of the average daily price of the Common Stock on the date the Company furnishes HSBC with a draw down notice.

The shares issuable upon acceptance of all Draw Down Requests and upon exercise of the Warrants are the subject of this Prospectus.

The term of the Financing Arrangement is for twelve months from the initial Draw Down, unless earlier terminated by either party or extended by mutual consent of the parties.

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USE OF PROCEEDS

The Company will not receive any proceeds from the sale of the Shares by the Selling Stockholder. However, the Company will receive proceeds from the draw downs, the Call Options, if any, and the exercise of the warrants issued pursuant to the Financing Arrangement. The Company expects to use the net proceeds (after deduction of estimated offering expenses payable by the Company) from the Financing Arrangement for general corporate purposes.

DIVIDEND POLICY

The Company has never declared or paid cash dividends on its Common

Stock. The Company currently anticipates that it will retain all available funds for use in the operation of its business, and therefore does not anticipate paying any cash dividends on the Common Stock in the foreseeable future.

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

On July 18, 1996, the Company successfully completed its IPO and sold 2,415,000 Units at a price of \$5.50 per Unit. Each Unit consisted of one share of Common Stock and one Redeemable Warrant to purchase a share of Common Stock at \$9.00 ("Unit"). Units were traded on the NASDAQ SmallCap Market from July 18, 1996 until August 20, 1996, at which time the Units were delisted from the exchange. The Common Stock and the Redeemable Warrants have traded separately on the NASDAQ SmallCap Market since July 29, 1997 under the symbols XYBR and XYBRW.

As of June 30, 1998, there are approximately 1,200 holders of Common Stock. There have been no cash dividends paid on the Company's Common Stock to date and the Company does not anticipate the payment of dividends in the foreseeable future.

The table below sets forth by quarter, for the periods indicated, the high and low market prices of the Company's Common Stock and Redeemable Warrants. Quotations reflect prices between dealers, without retail mark-up, mark down or commissions and may not necessarily represent actual transactions.

<TABLE>

<CAPTION>

	Common Stock		Redeemable Warrants	
	High ----	Low ---	High ----	Low ---
<S>	<C>	<C>	<C>	<C>
Fiscal 1996				
1st Quarter.....	--	--	--	--
2nd Quarter.....	--	--	--	--
3rd Quarter.....	12	4 1/2	6 1/4	1 3/8
4th Quarter.....	4 7/8	1 1/2	2 1/4	5/8
Fiscal 1997				
1st Quarter.....	4 11/16	1 29/32	1 11/32	13/32
2nd Quarter.....	3 1/2	1 5/16	7/16	3/16
3rd Quarter.....	5 9/16	2 3/8	23/32	3/16
4th Quarter.....	4	1 25/32	17/32	5/32
Fiscal 1998				
1st Quarter.....	2 1/2	1 3/8	13/32	5/32
2nd Quarter.....	8 7/16	1 13/32	1 3/4	1/8

</TABLE>

SELECTED FINANCIAL DATA

The following selected financial data as of December 31, 1997, and for each of the two years then ended, have been derived from the Company's consolidated financial statements, which statements have been audited by PricewaterhouseCoopers LLP, independent accountants, as set forth in their report dated March 31, 1998, which includes an explanatory paragraph, concerning the Company's ability to continue as a going concern. The selected financial data as of June 30, 1998 and for the six months ended June 30, 1998 and 1997, have been derived from the unaudited consolidated financial statements of the Company and, in the opinion of management, contain all adjustments (consisting only of normal and recurring adjustments) that the Company considers necessary for a fair presentation of such data. The result of the interim periods are not necessarily indicative of the results of a full year. All of the financial data set forth below should be read in conjunction with the consolidated financial statements of the Company and the notes thereto included elsewhere in this Prospectus and also with the information appearing under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations."

<TABLE>

<CAPTION>

	Year Ended December 31,		Six Months Ended June 30,	
	1997 ----	1996 ----	1998 ----	1997 ----
<S>	<C>	<C>	<C>	<C>
Revenue:				
Product sales and leases	\$555,522	\$ 928,732	\$356,861	\$220,458
Consulting and license	257,000	164,609	1,839	30,000
	-----	-----	-----	-----

Total revenue	812,522	1,093,341	358,700	250,458
Cost of sales	1,225,572	1,081,197	379,476	409,790
Gross profit (loss)	(413,050)	12,144	(20,776)	(159,332)
Operating expenses:				
Sales and marketing	3,280,356	1,442,146	1,151,147	1,489,195
General and administrative	3,518,868	2,158,212	1,617,879	1,885,214
Research and development	2,350,237	1,773,015	1,010,769	1,196,319
Total operating expenses	9,149,461	5,373,373	3,779,795	4,570,728
Operating loss	(9,562,511)	(5,361,229)	(3,800,571)	(4,730,060)
Interest income, net	82,545	122,693	8,066	49,129
Net loss	(9,479,966)	(5,238,536)	(3,792,505)	(4,680,931)
Provisions for preferred stock	571,598	---	2,344	---
Net loss applicable to holders of common stock	\$ (10,051,564)	\$ 5,238,536	\$ 3,794,849	\$ 4,680,931
Net loss per share applicable to holders of common stock	\$ (0.78)	\$ (0.47)	\$ (0.22)	\$ (0.38)
Weighted average number of common shares outstanding (basic and diluted)	12,844,974	11,121,594	17,016,067	12,459,112

</TABLE>

	December 31, 1997	June 30, 1998
Balance Sheet Data:		
Working capital.....	\$1,753,477	\$4,492,263
Total assets.....	4,531,617	7,433,903
Total liabilities.....	1,357,682	1,277,405
Stockholders' equity.....	3,173,935	6,156,498

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

The following discussion should be read in conjunction with the consolidated financial statements of the Company and notes thereto, and is qualified in its entirety by the foregoing and by other more detailed financial information appearing elsewhere in this Prospectus.

Results of Operations

The following table sets forth certain consolidated financial data as a percentage of revenues for the years ended December 31, 1997 and 1996 and the six month periods ended June 30, 1998 and 1997.

<TABLE>

<CAPTION>

	Year Ended		Six Months Ended	
	December 31, 1997	December 31, 1996	June 30, 1998	June 30, 1997
<S>	<C>	<C>	<C>	<C>
Revenues.....	100.0%	100.0%	100%	100%
Cost of sales.....	150.8	98.9	105.8	163.6
Gross margin.....	(50.8)	1.1	(5.8)	(63.6)
Operating expenses:				
Sales and marketing.....	403.7	131.9	320.9	594.6
General and administrative.....	433.1	197.4	451.0	752.7
Research and development.....	289.3	162.2	281.8	477.7
Total operating expenses.....	1,126.1	491.5	1,053.7	1,825.0
Interest income, net.....	10.2	11.3	2.2	19.6
Net loss.....	(1,166.7)	(479.1)	(1,057.3)	(1,869.0)
Provisions for preferred stock.....	70.3	-	0.6	-

Net loss applicable to holders of common stock.....	(1,237.1)%	(479.1)	(1,057.9%)	(1,869.0%)
	=====	=====	=====	=====

</TABLE>

Six Months Ended June 30, 1998 Compared to Six Months Ended June 30, 1997

Revenues. Total revenues for the six months ended June 30, 1998 were \$358,700, an increase of \$108,242, or 43%, compared to \$250,458 for the corresponding period in 1997. Product revenues for the six months ended June 30, 1998 were \$356,861, an increase of \$136,403, or 62%, compared to \$220,458 for the corresponding period in 1997. The increase in product revenues for the three months ended June 30, 1998 was related to the higher number of 133P Systems that were sold during that period, compared to the lower number of 486 and 586 Systems that were sold in the corresponding period in 1997. The decrease in consulting and license revenues was due to the lack of sales activity under a license agreement with Rockwell International that was related to the restructuring of Rockwell's operations.

Cost of sales. The cost of goods sold for the six months ended June 30, 1998 was \$379,476, a decrease of \$30,314, or 7%, compared to \$409,790 for the corresponding period in 1997. The cost of goods sold increased commensurately with the increase in sales but were offset by charges in 1997 of approximately \$97,000 of parts for 586 Systems that were replaced and written off, and by a full reserve for obsolescence of approximately \$225,000 for the remaining computing units used in 486 Systems that are believed by Company management to be saleable, but whose value is uncertain given changes in technology and advances in the market.

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Sales and marketing expenses. Sales and marketing expenses for the six months ended June 30, 1998 were \$1,151,147, a decrease of \$338,048, or 23%, compared to \$1,489,195 for the corresponding period in 1997. This decrease was due to a change in compensation structure for sales personnel which resulted in lower base salaries, a reduction in travel related expenses due to the centralization of sales staff, and a decrease in the use of outside consultants for sales and marketing programs.

General and administrative expenses. General and administrative expenses for the six months ended June 30, 1998 were \$1,617,879, a decrease of \$267,335, or 14%, compared to \$1,885,214 for the corresponding period in 1997. This decrease resulted primarily from a reduction in personnel and related occupancy expenses, along with a decrease in travel expenses. These were partially offset by an increase in activities related to international operations.

Research and development expenses. Research and development expenses for the six months ended June 30, 1998 were \$1,010,769, a decrease of \$185,550, or 16%, compared to \$1,196,319 for the corresponding period in 1997. This decrease resulted primarily from reduced activity and related expense given the substantial completion of development for the head-mounted display and the body-worn computing unit for the 133P, and the sharing of development expenses for the Mobile Assistant IV System with the Company's development and manufacturing partners.

Interest income, net. Net interest income for the six months ended June 30, 1998 was \$8,066, a decrease of \$41,063, or 84%, compared to \$49,129 for the corresponding period in 1997. This decrease is the result of reduced interest income from the lower average cash balances in the six months ended June 30, 1998 than for the corresponding period in 1997, which reflected the interest income on proceeds from the Company's initial public offering that was completed in July 1996.

Dividend on preferred stock. The Company's Series C Preferred Stock was issued on May 15, 1998 and accrues dividends at 5% per annum on the outstanding principal amount. For the six months ended June 30, 1998, the amount of accrued dividend was \$2,344, with no comparable item for the corresponding period in 1997.

Net loss attributable to common stock. As a result of the factors described above, the net loss for the six months ended June 30, 1998 was \$3,794,849, a decrease of \$886,082, or 19%, compared to \$4,680,931 for the corresponding period in 1997. Although the Company was subject to taxation during the six months ended June 30, 1998 and the six months ended June 30, 1997, the Company incurred net losses during these periods and no provision for taxes was made.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues. Revenues for the year ended December 31, 1997 were \$812,522,

a decrease of \$280,819, or 26%, compared to \$1,093,341 for the year ended December 31, 1996. Product revenues for the year ended December 31, 1997 were \$555,522, a decrease of \$373,210 or 40%, compared to \$928,732 for the corresponding period in 1996. The reduction in product revenues for the year was related to the lower number of 133P Systems and Mobile Assistant(R) II Systems that were sold during that period, compared to the higher number of 486 Systems that were sold in the corresponding period in 1996. Consulting and license revenues for the year ended December 31, 1997 were \$257,000, an increase of \$92,391, or 56%, compared to \$164,609 for the corresponding period in 1996. During the year ended December 31, 1997, the Company's licensee informed the Company that as a result of the restructuring of its business operations, the licensee had elected to not continue with its business activities under the license. A portion of the consideration received by the Company in March 1996 for granting this license was a \$300,000 cash payment, which the Company recorded as deferred license revenue and was amortizing this amount over a five year period. Given the licensee's stated intent to not to continue conducting business operations under the license, the remaining deferred licensing revenue of \$220,000 as of June 30, 1997 was recorded as revenue in the three months ended September 30, 1997.

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Cost of sales. The cost of sales for the year ended December 31, 1997 was \$1,225,572, an increase of \$144,375, or 13%, compared to \$1,081,197 for the year ended December 31, 1996. The cost of goods sold decreased commensurately with the decrease in product sales but was offset by charges of approximately \$725,000 to reduce the carrying value of the computing unit for the 486 System and the Mobile Assistant(R) II to estimated market value and to reduce carrying values of several components of the Company's head-mounted displays to estimated market value.

Research and development expenses. Research and development expenses for the year ended December 31, 1997 were \$2,350,237, an increase of \$577,222, or 33%, compared to \$1,773,015 for the year ended December 31, 1996. This increase reflects the Company's ongoing research and development efforts, including the addition of new personnel, the operation of the design center in California, the internal development of a head-mounted display, the development of the body-worn computing unit for the Mobile Assistant(R) II, the 133P and the MA IV, and software development.

Sales and marketing expenses. Sales and marketing expenses for the year ended December 31, 1997 were \$3,280,356, an increase of \$1,838,210, or 128%, compared to \$1,442,146 for the year ended December 31, 1996. This increase resulted mainly from increases in personnel, related travel, infrastructure costs to support sales, VAR training programs, customer service, additional marketing programs to support the launch of new products, and public and investor relations efforts, and expenses related to the establishment of a representative office in Tokyo, Japan and negotiations with potential licensees in Far East and Europe, along with charges of approximately \$253,000 related to a receivables whose collectability was deemed to be doubtful and were written off and an expense of approximately \$125,000 related to the issuance of warrants to a consultant.

General and administrative expenses. General and administrative expenses for the year ended December 31, 1997 were \$3,518,868, an increase of \$1,360,656, or 63%, compared to \$2,158,212 for the year ended December 31, 1996. This increase resulted primarily from an increase in personnel, consulting, and travel expenses related to the expansion and continued development of the Company's infrastructure, and activities related to discussions regarding certain strategic partnerships and international operations.

Interest income, net. Net interest income for the year ended December 31, 1997 was \$82,545, an decrease of \$40,148, or 33%, compared to net interest income of \$122,693 for the year ended December 31, 1996. This decrease is primarily the result of lower average monthly cash balances in fiscal 1997 versus those during fiscal 1996, when cash was received from the Company's IPO.

Dividend on preferred stock, deemed dividend accretion on preferred stock. The Company's Series A Preferred Stock was issued on June 30, 1997 and accrues dividends at 5% per annum on the outstanding principal amount. The Company's Series B Preferred Stock was issued on November 11, 1997 and accrues dividends at 4% per annum on the outstanding principal amount. For the year ended December 31, 1997, the amount of accrued dividend was \$82,905, with no comparable item for the corresponding period in 1996. In accordance with the Emerging Issues Task Force report from the Securities and Exchange Commission titled "Accounting for the Issuance of Convertible Preferred Stock and Debt Securities with a Nondetachable Conversion Feature," a deemed dividend was assumed for the Series A and Series B Preferred Stock, which will be accreted periodically as portions of the Series A and Series B Preferred Stock are convertible into Common Stock. The amount of this accretion for the year ended December 31, 1997 was \$488,693, with no comparable item for the corresponding

period in 1996. Additional paid in capital is reduced by the amount of accretion and preferred stock is increased by the amount of accretion, resulting in no impact on the overall amount of stockholder's equity.

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Net loss attributable to holders of common stock. As a result of the factors described above, the net loss attributable to holders of Common Stock for the year ended December 31, 1997 was \$10,051,564, an increase of \$4,813,028, or 92% compared to \$5,238,536 for the year ended December 31, 1996. Although the Company was subject to taxation during the year ended December 31, 1997 and the year ended December 31, 1996, the Company incurred net losses during these periods and no provision for taxes was made.

Liquidity and Capital Resources

Since its inception until the completion of the IPO, the Company financed its operations from the private sale of its securities, from vendor credit and from short-term loans received from management, stockholders and others.

From October 1994 to August 1995 the Company raised approximately \$1,243,000 from the private sale of shares of Common Stock at \$6.00 per share. In November 1995, the Company raised \$1,505,000 through the private placement of convertible debentures and in April 1996, the Company raised \$1,000,000 through a second private placement of convertible debentures. The Company received approximately \$2,140,000 from these financings net of offering costs. The placement fees in respect of these financings were carried by the Company as interest-bearing loans and were repaid from the proceeds of the IPO and realized gross proceeds of approximately \$13,280,000 and net proceeds of approximately \$10,840,000 after related expenses.

On June 30, 1997, the Company completed a \$3 million private placement of an aggregate of 3,180 shares of the Company's Series A Preferred Stock, par value \$0.01 per share ("Series A Preferred Stock"), and realized gross proceeds of \$3,000,000 and net proceeds of approximately \$2,762,000 after related expenses. All of such Series A Preferred Stock has been converted as of the date hereof resulting in the issuance of 1,958,984 shares of Common Stock.

On November 12, 1997, the Company completed a \$3 million private placement of an aggregate of 3,000 shares of the Company's Series B Preferred Stock, par value \$0.01 per share ("Series B Preferred Stock"), and realized gross proceeds of \$3,180,000 and net proceeds of approximately \$2,950,000 after related expenses. On February 23, 1998, the Company completed a follow-on placement of its Series B Preferred Stock and realized gross proceeds of \$1,000,000 and net proceeds of approximately \$990,000 after related expenses. All of such Series B Preferred Stock has been converted as of the date hereof resulting in the issuance of 3,172,239 shares of Common Stock.

In April 1998, the Company entered into an equity line of credit agreement with institutional investors who had formerly invested in the Company in which the Company received an initial gross amount of \$1,000,000 in exchange for Common Stock. Under this line of equity the Company has the right, but not the obligation, to obtain up to an additional \$10,000,000 in a series of equity draw downs based on terms and conditions specified in the line of credit. In connection with this line of equity, the Company issued warrants to purchase up to 40,000 shares of stock at \$1.76 and 20,000 shares of stock at \$2.81 at any time starting six months after closing and ending five years after closing. The placement agent for this transaction received a cash fee of 5% and 50,000 shares of unregistered stock.

In May 1998, the Company completed a \$750,000 private placement of an aggregate of 375 shares of the Company's Series C Preferred Stock, par value \$0.01 per share ("Series C Preferred Stock") and 110,294 shares of Common Stock with institutional investors who had formerly invested in the Company. The Series C Preferred Stock has a stated value of \$1,000 per share and a holder of the Series C Preferred Stock is entitled to receive, if and when declared by the Company, a dividend equal to 5% of the stated value per share per annum, payable in shares of Common Stock or in cash, payable upon conversion of the Series C Preferred Stock. The Series C Preferred Stock also provides the Company with several redemption options and allows for the periodic

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conversion of portions of unredeemed Series C Preferred Stock over a two-year period ending May 15, 2000. Any Series C Preferred Stock outstanding on May 15, 2000 must be converted into Common Stock at that date.

In June 1998, the Company completed a \$1,000,000 private placement with an

institutional investor who had formerly invested in the Company in which the Company issued 153,846 unregistered shares of Common Stock at a price of \$6.50 per share.

In June 1998, the Company amended and exercised a put option in the aggregate principal amount of \$3,000,000 under the private equity line of credit agreement mentioned above. In connection with such action, the Company issued 545,454 shares of Common Stock. Such shares are subject to restrictions on resale for a period of nine months and to repricing upon occurrences of certain conditions. In addition, the Company issued five-year warrants to purchase up to 300,000 shares of Common Stock at a price of \$5.25.

For the six months ended June 30, 1998, the Company's operating activities used cash of \$3,366,073. The net use of cash by operations for the six months ended June 30, 1998 was primarily the result of a \$3,792,505 net loss. This was offset by a net decrease in inventories of \$109,731, depreciation and amortization of \$152,185 and non-cash charges for tooling costs of \$138,682. Cash used for investing activities for the six months ended June 30, 1998 was \$198,765 which included \$91,190 related to patents and \$74,060 in capitalized tooling costs. Proceeds from the Company's financing activities for the six months ended June 30, 1998 were \$6,627,195 which primarily consisted of \$5,307,048 from the issuance of the Company's Common Stock, net of related fees and \$1,348,496 from the issuance of the Company's Series B and Series C Preferred Stock, net of related fees. As a result of the above, cash and cash equivalents on hand as of June 30, 1998 was \$4,014,723, an increase of \$3,062,357 from the \$952,366 of cash and cash equivalents on hand as of December 31, 1997.

For the six months ended June 30, 1997, the Company's operating activities used cash of \$4,986,509. The net use of cash for the six month period ended June 30, 1997 was primarily the result of a \$4,680,931 net loss, an increase in inventories of \$295,792 largely related to the production of the 586 System and the Company's head mounted display, an increase in prepaid and other current assets of \$184,312, offset by depreciation and amortization costs of \$160,547 and non-cash compensation costs of \$125,488. Cash used for investing activities for the six months ended June 30, 1997 was \$747,144 which included \$306,962 for the acquisition of property and equipment, \$284,294 in capitalized tooling costs related to the production of the 586 System and the Company's head mounted display, and \$155,188 related to patents. Proceeds from the Company's financing activities for the six months ending June 30, 1997 were \$2,951,076 which primarily consisted of \$2,785,000 from the issuance of its Series A Preferred Stock and deferred placement fees of \$215,000. As a result of the above, cash on hand as of June 30, 1997, was \$3,492,390, a decrease of \$2,782,577 from the \$6,274,967 of cash and cash equivalents on hand as of December 31, 1996.

For the year ended December 31, 1997, the Company's operating activities used cash of \$10,062,427 compared to a use of \$5,133,942 for the year ended December 31, 1996. The net use of cash during the year ended December 31, 1997 was primarily the result of a \$9,479,966 net loss and cash used by inventory of \$1,930,378, offset by a net increase in accounts payable and accrued expenses of \$515,466 and depreciation and amortization of \$277,299. Cash used by investing activities for the year ended December 31, 1997 was \$866,228, which included \$364,678 for the acquisition of property and equipment, \$231,298 related to obtaining and maintaining patents and \$270,252 in capitalized tooling costs. Proceeds from the Company's financing activities for the year ended December 31, 1997 were \$5,606,054 which primarily consisted of \$5,710,406 from the issuance of the Company's Series A Preferred Stock and Series B Preferred Stock, and \$56,500 of proceeds from notes and loans, offset by payments on notes and loans totaling \$72,232, and \$16,667 for the remaining payment on the acquisition of Tech Virginia and repayment of loans. As a result of the above, cash and cash equivalents on hand as of December 31, 1997 was \$952,366, a decrease of \$5,322,601 from the \$6,274,967 of cash on hand as of December 31, 1996.

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For the year ended December 31, 1996, the Company's operating activities used cash of \$5,133,942. The use of cash by operations for the year ended December 31, 1996 was primarily the result of a \$5,238,536 net loss combined with \$354,871 of cash used by inventories, \$337,065 used by accounts receivable and \$177,094 for prepaid and other assets, offset by an increase in accounts payable and accrued expenses of \$177,619 and an increase in deferred licensing revenue of \$250,000. Cash used by investing activities in the year ended December 31, 1996 consisted of \$315,257 for the acquisition of property and equipment, \$114,618 related to the acquisition of patents, and \$106,738 of capitalized tooling and other assets. Proceeds from the Company's financing activities in the year ended December 31, 1996 consisted primarily of \$13,282,500 raised at the Company's Initial Public Offering ("IPO") and \$1,000,000 from the placement of Convertible Debentures prior to the IPO, offset by fees of \$2,561,149 and net loan repayments of \$251,161.

At June 30, 1998, the Company had no material capital commitments and

working capital of \$4,492,263.

In September 1998, the Company entered into the Financing Arrangement with the Selling Stockholder pursuant to which, the Company may, at its option, sell up to \$31,200,000 of Common Stock to the Selling Stockholder during a twelve month period, and the Selling Stockholder may exercise its Call Option for an additional \$31,200,000. To fully utilize the Financing Arrangement, the Company may need to register additional shares of Common Stock. See "Financing Arrangement."

The Company anticipates that its working capital requirements and operating expenses will increase as the Company expands production and sales of the Mobile Assistant(R), and expands its full sales, service and marketing functions, and develops the support structure for these activities. The timing of increases in personnel and other expenses, the amount of working capital consumed by operations, marketing and rollout expenses for the MA IV, and competitive pressures on gross margins will impact the magnitude and timing of the Company's cash requirements. To meet working capital needs, the Company has entered into the Financing Arrangement with the Selling Stockholders (see "Financing Arrangement") and in the event the Financing Arrangement is terminated and funding thereunder is not available, the Company may also exercise an existing put option to sell up to \$7,000,000 of Common Stock under the Private Equity Line of Credit Agreement described above. In addition, the Company intends to use funds from operations, and may obtain a working capital line of credit and/or complete additional financings, if necessary. It is the opinion of the Company's management that additional funding arrangements are readily available to the Company and the execution of any such arrangement will depend on timing, market conditions and the final terms and conditions of such arrangements. Full production of the MA IV model of the Mobile Assistant(R) will begin in the quarter ending December 31, 1998 and receivables from sales of the MA IV are expected to provide collateral for borrowing facilities at that point. Although there can be no assurance that such facilities will be available, the Company intends to seek to establish secured borrowing facilities at such time as appropriate collateral is available. The Company's management believes that the combination of cash on hand, operating cash flow, and outside funding will provide sufficient liquidity to meet the Company's cash requirements until at least March 1999. However, there can be no assurance that the Company can or will obtain sufficient funds from operations or from a working capital line of credit or from closing additional financings on terms acceptable to the Company.

Possible Impact on Near-Term Revenues

The Company has agreements with third-party suppliers to manufacture and supply the body-worn computing unit, the HMD and the batteries for the 133P and the MA IV. Production of the computing unit for the 133P has been substantially curtailed pending the introduction of the MA IV in the fourth quarter, although management believes that it can restart production to meet large orders. As a result, revenue growth is expected to be modest through the first three quarters of the year ending December 31, 1998, until full-scale production by these MA IV suppliers is started and these units are sold in volume, which is expected to begin in the quarter ending December 31, 1998. In the event that the start of full-scale production is delayed for any reason, revenues for the year ending December 31, 1998 will be adversely affected.

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Exchange rates for some local currencies in countries where the Company operates may fluctuate in relation to the U.S. dollar and such fluctuations may have an adverse effect on the Company's earnings when local currencies are translated into U.S. dollars.

Possible Non-Cash Future Charge

As a condition to the Company's initial public offering (the "IPO"), certain of the Company's stockholders, primarily officers and directors, have been required to deposit an aggregate of 1,800,000 shares of Common Stock into an escrow account (the "Escrowed Shares"). The Escrowed Shares are subject to incremental release over a three-year period only in the event the Company's gross revenues and earnings (loss) per share for the 12-month periods ending September 30, 1997, 1998 and 1999 equal or exceed certain gross revenue and earnings (loss) per share targets. If such per share targets are not met in any of the relevant 12-month periods (and the price of the Common Stock does not meet or exceed the price described below), certain agreed upon amounts of the Escrowed Shares will be returned to the Company for each period and canceled. In addition to the foregoing, all the then Escrowed Shares will be released to the stockholders if the closing price of the Common Stock as reported on The Nasdaq SmallCap Market following this offering equals or exceeds \$11.00 for 25 consecutive trading days or 30 out of 35 consecutive trading days during the period ending September 30, 1999. In the event any Escrowed Shares held by officers, employees and consultants are released, the difference between the

initial offering price and the market value of such shares at the time of release will be deemed to be additional compensation expense to the Company which, depending on the price per share, may have the effect of reducing or eliminating any earnings per share and could have a negative effect on the market price for the Common Stock. The stock and earnings targets for escrow release for September 30, 1997 were not achieved and 300,000 shares were canceled from the escrow pool, which resulted in a reduction of 2.1% of the Company's outstanding shares of Common Stock. Given the expenditures related to the start of full-scale production of the MA IV in the quarter ending December 31, 1998, the Company's management believes that it is likely that the Company's gross revenues and allowable losses will not meet the Performance Targets for the 12-month period ending September 30, 1998 thereby resulting in 750,000 shares of stock being canceled from the escrow pool, which will result in a reduction of 3.6% of the Company's outstanding shares of Common Stock..

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BUSINESS

General

The Company is engaged in the research, development and commercialization of mobile computer systems and related software solutions designed to enhance personal productivity, especially in commercial, industrial and military applications. The Company's current mobile computing product is the Mobile Assistant(R) 133P model, which is a full-function, body-worn, voice-controlled 133Pentium computer with a head-mounted video display. The Company has delivered both developmental and sales samples of its new MA IV system, and will begin full production of this next-generation series. With the speed, memory, processing, multimedia and communication capabilities of a desktop PC in a lightweight unit, the Mobile Assistant(R) Series combines full-function PC features with hands-free operation and simultaneous user mobility. The Mobile Assistant(R) is a combination of hardware and software specifically designed for body-worn mobile computing. The Mobile Assistant(R) Series with application software is designed to allow workers with minimal training to perform complex and time consuming tasks such as maintenance, repair and inspection of complex technological and mechanical systems, retrieval and analysis of medical information from remote locations, and coordination of remote commercial and industrial activities and military field operations, in a more efficient manner than current technology allows. Purchasers of the Mobile Assistant(R) Series have included, among others, AT&T, Lucent, NTT (Nippon Telegraph and Telephone), Eaton Corporation, Fujitsu, Battelle Memorial Institute, Shell Oil, Mitsubishi, Rockwell International, Lockheed Martin, and the United States Army and Navy. In March 1996, Rockwell International, which manufactured the computing unit utilized in the Mobile Assistant I(R), licensed from the Company the right to manufacture and market mobile computers utilizing certain intellectual property and related technical know-how which has been developed by the Company.

The Mobile Assistant(R) Series can utilize technologically advanced features such as real time two-way video and audio communications through radio frequency transmissions, integrated cellular linkups, global positioning system tracking capabilities and access to information through the Internet and World Wide Web. The new HMD/FPD includes a two-way audio system and optional built-in video camera, weighs approximately 15 ounces and presents a desk-top quality full VGA color image that is approximately equivalent to that of a 15" VGA monitor at a distance of approximately two feet. An optional light-weight, 6.4 inch, full VGA color, flat panel display, with integrated digitizer, is offered for users who do not desire an HMD or do not need to be 100% hands-free and feet-free to perform their job. The body-worn computing unit is designed to allow operation in environmental conditions in which conventional portable computers could not previously operate, weighs less than two pounds and is capable of running software applications designed for Microsoft(R) Windows(R) 3.11, Windows(R) 95 and 98, Windows(R) NT(TM), DOS, SCO UNIX(R) and LINUX.

The Company offers novel software products, including the following two designed to get user documentation up and running on the Mobile Assistant quickly, that can be used on the Mobile Assistant(R) or conventional desktop or laptop computers. The Company's linkAssist(TM) software allows users to develop applications that need for information to be quickly and easily linked together regardless of the format of the data or where it is stored, avoiding the need to change, convert or reenter the existing information or to use the very technical HTML tagging process. An interesting and useful feature of this product is that the linked words or phrases can then be activated by voice automatically, with no development work by the author of the documentation or databases. The webAssist(TM) software offered by the Company allows voice navigation of HTML document links such as those found on web sites on the World Wide Web and intranets. This provides the user with hands-free access to all of the information found on, for example, manufacturer and supplier and company-owned, web sites. Additional authoring and inspection toolkits are in development and are expected to available this calendar year.

Industry Overview

Since the introduction of the first large mainframe computers in the 1950's, there has been an ongoing evolution in computer hardware to reduce size and increase performance and functionality. The commercialization of mobile computing products combined with significant increases in the number and scope of software applications has resulted in a multi-billion dollar market. The Company sees the next phase in this evolution to be body-worn, voice-activated computers, which will provide hands-free portability. The Company believes that the potential to develop a substantial market for its mobile computing hardware and software products is demonstrated by the substantial historic and projected growth in all forms of mobile and portable computers. According to MarkIntel, a service which compiles market research reports, total revenues from the overall portable computer market (20 pounds or lighter), will have an average annual growth of approximately 13% to over \$23 billion through the year 2000. MarkIntel reports that notebook computers (i.e. weighing from 5 to 8 pounds) currently constitute over 70% of portable units sold. MarkIntel also states that sub-notebook computers (3 to 5 pounds) currently constitute approximately 15% of sales of portable computers and are expected to increase to almost 19% of sales by the year 2000. Mini-computing and communication devices (3 pounds or less, and which still are considered to be in an evolutionary cycle) are projected by MarkIntel to experience an average annual revenue growth rate of 33%. The Company believes that these projected figures demonstrate the significant potential size of this still-evolving market for various forms of mobile and portable computers.

In conjunction with the changes in computer hardware, a similar evolution has occurred in computer software to move from processing data to providing information. Mainframe computers were initially used to process vast amounts of data such as population statistics, corporate accounting information, etc., for users. With personal computers came software to provide information to users in the form of analysis, relationships, etc. The Company believes that providing "how to" knowledge to users is the next step in the evolution of the computer software and one that is well suited for use with body-worn computers.

Business Strategy

The Company's objective is to be the leading provider of voice-activated, hands-free mobile computing systems and related software to enhance productivity in a wide variety of applications for commercial, industrial and military customers. To achieve this objective, the Company intends to pursue the following strategies:

Develop and Strengthen Strategic Alliances. The Company has established and intends to continue to establish strategic alliances with world-class distribution partners, as well as selected systems integrators, independent software vendors, VARs, OEMs and industrial and commercial equipment and service providers. The benefits that the Company receives from these associations include access to a larger potential customer base, complementary technologies, reduced capital investment through utilization of outside resources, and access to manufacturing expertise and efficiencies of world-class manufacturers. The Company has already announced signed distribution and support agreements with En Pointe for North American distribution, Hewlett Packard for European, Middle East and African distribution and support, and with Nissho Iwai for Far East distribution. All agreements have resulted in a worldwide distribution network to be operational this calendar year to support the launch of the MA IV Series. Additionally, large systems integrators, such as DynCorp, have already been signed to both provide implementation support for Xybernaut customers worldwide as well as to place our products within their own client bases. The Company has been pursuing, and will continue to pursue, additional strategic associations to enhance its product offerings and expand its marketing activities.

In addition to marketing and support strategic relationships, the company has signed and is executing other developmental relationships with organizations such as the SBS in Europe (over 30 software companies serving as a Xybernaut Center of Excellence for speech and wearable applications), and companies in the USA and Asia for hardware development and field testing of application-specific solutions for industry.

Provide Custom Software Solutions for Diverse Customer Needs. The Company intends to continue the development, or acquisition of, software that enables its customers to more rapidly create customized software applications for use with the Mobile Assistant(R) Series and on conventional PCS. This software will be designed

to provide prepackaged application expertise that incorporates the end user's existing programs, procedures and technical documentation, thereby permitting the cost-effective development of productivity-enhancing software applications by customers. The Company believes that revenue from software will become an important contributor to operating margins in the future.

Penetrate Target Markets Through Licensees, OEMs, VARs, Distributors, and Direct Sales. The Company believes that its mobile computing technology is especially well suited for the repair and maintenance of commercial, industrial and military equipment and facilities. The Company also believes that forms-based applications, such as inventory and data collection, are extremely well-suited for its flat panel display configuration, requiring the user to carry only a 1 - 1 1/2 pound VGA color display/digitizer instead of their current much heavier pen tablets offering only limited computing power. The Company intends to penetrate its target markets through effective use OEMs, VARs and distributors that demonstrate comprehensive market knowledge in their markets. Through the use of already approved, as well as additional Distributors, Systems Integrators, Industrial and Commercial Equipment Suppliers, Independent Software Suppliers, OEMs and VARs, the Company intends to leverage internal marketing and sales resources, and achieve rapid foreign and domestic market penetration resulting in a diversified customer base. The Company also intends to continue marketing directly to key national accounts in order to build multiple reference accounts for its distributors to use to quickly expand their own sales world-wide. These reference accounts also provide the Company's RD&E organizations with valuable unfiltered feedback from customers for future product development. The Company expects that as large computer and equipment manufacturers attempt to enter the wearable or user-supported computing marketplace that it will have numerous opportunities to license its strong intellectual property. Such licensing, the Company believes, will yield significant revenue as well as accelerated market penetration.

Achieve and Maintain Technology Leadership. The Company is committed to achieving and maintaining technological superiority of the Mobile Assistant(R) Series and its other mobile computing hardware and software products through the continuous reassessment of product performance and the utilization and integration of state of the art hardware and software technologies. The Company believes that the substantial expenditure of time and effort in developing the Mobile Assistant(R) Series has resulted in a set of core competencies which provide the Company with a solid foundation in the hands-free, mobile computing industry. The Company intends to maintain this advantage through ongoing research and development, which will ensure that the Mobile Assistant(R) Series will continue to provide a full range of PC capabilities, including two-way video communication and access to the Internet, intranets, remote databases and other computerized reference resources. The Company also intends to rely heavily on joint developments with its strategic partners worldwide, and cross-licensing of its valuable intellectual property to build and market new technology. The current MA IV Series, for example, was the result of the Company's successful relationships with Fujitsu, Sony Digital Products, Hitachi, Shimadzu, Toshiba, JAE and Moli Energy, all under the auspices of the Company's Japanese operations.

Commitment to Open Architecture. The Company utilizes standard PC hardware and software architectures and designs its products using open systems technologies, including industry standard operating systems and open system computer platforms. The Company continually evaluates the feasibility of integrating its software and hardware products with new technologies as these are developed and accepted in the marketplace. The Company anticipates that its current products will be upgraded to incorporate, and its future products designed using open architectures to allow use with existing and emerging standards in hardware and software technology.

Leverage Core Competencies. The Company believes its core competencies, which have been developed since its inception, are the integration and adaptation of innovative computer hardware and software technologies into hands-free mobile computing products that enhance end user productivity. The Company will seek to expand applications for its technologies and to capitalize on the breadth of its expertise by assisting its customers in the development of new hardware and software products. Consistent with this strategy, the Company will continue to focus on integration of hands-free mobile computing hardware with internally developed, or acquired, software applications and hardware products. The Company's goal is to adhere to the model of an Intellectual Property-Virtual Hardware-Communications-Software Company, concentrating on RD&E and marketing strategies. It intends to continue to allow its strategic partners to execute the Company's

Company management. The Company intends to remain small and nimble, able to react quickly to market needs and world economic changes.

Products and Product Development

In order to address the market, which the Company believes exists for body-worn mobile computers, the Mobile Assistant(R) Series has been designed with five key features:

- o Compact, lightweight and rugged hardware specifically designed for mobile, body-worn use
- o Easy to use human interface
- o Voice command control
- o Head-worn miniature display
- o Flat panel miniature display/digitizer

Compact Hardware for Mobile, Body-Worn Use. The MA IV currently utilizes primarily off-the-shelf miniaturized hardware components in a body-worn computing package weighing under two pounds. Design features for the MA IV currently include:

- o Intel Pentium(R) 200 or 233 MHZ processor w/ 512 KB L2 cache (266 MHZ scheduled for early 1999)
- o Extended Data Output ("EDO") RAM (currently ranging from 32 Mb to 128 Mb)
- o Internal hard disk currently ranging from 2 - 4 GB (8GB scheduled for early 1999)
- o Protected internal dual PC Card readers using CardBus (industry-standard peripheral cards)
- o Enclosure to allow use in a wide range of environmental conditions
- o Advanced-technology, hot-swappable lithium-ion battery and charger
- o HMD/FPD, USB, Power and Replicator ports
- o Mini-port replicator for mobile use, and desk-top port replicator
- o Wrist-mounted miniature keyboard
- o Miniature integrated full color video camera
- o Compatibility with DOS, Windows(R) 3.11(TM), Windows(R) 95 and 98, Windows(R) NT(TM) , SCO UNIX(R) and LINUX operating systems
- o Integrated pointing device (mouse)
- o Built-in sound system for speech recognition and generation

The Mobile Assistant(R) Series are full-featured "Wintel" PCS, which can readily be used as a desktop PC and allows for the incorporation of a wide range of capabilities including portable CD-ROM readers, bar code readers, battery-operated printers, still and motion video cameras, global positioning technologies, cellular and radio frequency communications and interfaces for medical and test equipment.

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Voice Command Control. The Mobile Assistant(R) supports state-of-the-art voice recognition software, hardware and algorithms to communicate digitized speech as input to the processor through an integrated analog-to-digital/digital-to-analog circuit. Significant user training generally is not required because the operable vocabulary is created in advance to be recognizable by a wide range of users or a phonetic engine is utilized. The system can also be programmed to "learn" the user, on the fly, during real-time field use. The speaker-independent approach works well for the menu and button-driven programs used in the Mobile Assistant(R). System accuracy is improved greatly since the words and phrases for each menu screen can be predetermined and used to limit recognition ranges to the screen at hand. The combination of voice recognition and head-worn display provides the user of the Mobile Assistant(R) with hands-free access to information and the ability to apply this information to operations and tasks with direct lines of sight and tactile access. In addition to basic command-and-control speech recognition, the MA IV also offers dictation features, and natural language speech processing is

planned for introduction in 1999. The Company's main speech development partners are IBM and Texas Instruments.

Head-Worn Miniature Display. The MA IV uses a lightweight HMD with 640 X 480 pixels (VGA color). It is anticipated that this display will be offered in color SVGA, 1280 X 1024 pixel resolution, and eventually in color resolutions exceeding those planned for High-Definition TV. All displays are approximately one square inch in size and use advanced optics to present an image to the user that is equivalent to a 15" desktop monitor at a distance of two feet. These displays are available in monocular form, and can be worn on a mounting device similar to a runner's visor or sunglasses, or on helmets, hardhats, soft baseball caps or similar headgear. These high quality, miniature displays present information in a heads-mounted display format without completely occluding vision.

Flat Panel Display. The MA IV uses an optional light-weight, 6.4 inch, full VGA color, flat panel display ("FPD"), with integrated digitizer, which is offered for users who do not desire an HMD or do not need to be 100% hands-free and feet-free to perform their job.

Computer Software for Mobile, Body-worn and Desk-top Use. The Company has two software products ready for the market, and two others in preparation for the market. All products, while designed to speed up the development of applications for the Company's line of wearable computers, are equally applicable to lap-top and desk-top applications.

The Company offers novel software products, including the following two designed to get user documentation up and running on the Mobile Assistant(TM) quickly, that can be used on the Mobile Assistant(R) or conventional desktop or laptop computers. The Company's linkAssist(TM) software allows users to develop applications that need for information to be quickly and easily linked together regardless of the format of the data or where it is stored, avoiding the need to change, convert or reenter the existing information or to use the very technical HTML tagging process. An interesting and useful feature of this product is that the linked words or phrases can then be activated by voice automatically, with no development work by the author of the documentation or databases. The webAssist(TM) software offered by the Company allows voice navigation of HTML document links such as those found on web sites on the World Wide Web and intranets. This provides the user with hands-free access to all of the information found on, for example, manufacturer and supplier and company-owned, web sites.

In addition to webAssist(TM) and linkAssist(TM), the Company has two other software products in development. Mobile Inspector(TM) is a toolkit to assist developers in the creation of inspection applications - whether the item under inspection is a car, a furnace or a human body. This toolkit, already proven without speech navigation and entry features, is being updated to incorporate the Company's speech recognition software offerings. The second product, as yet unnamed, is an authoring toolkit to quickly create Interactive Electronic Technical Manuals (combinations of expert software and electronic books and drawings and charts) and on-the-fly training programs. It is also expected to be ready for market in 1999.

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Marketing and Sales

Markets

The Company's marketing efforts are designed to increase awareness of and demand for its products in the commercial, industrial and military markets. The following are examples of selected horizontal and vertical markets that initially are being, or will be, addressed by the Company:

Commercial Maintenance and Repairs. Information from the United States Bureau of Labor Statistics and Bureau of Census indicates that as of 1996 there were more than 5,460,000 commercial mechanics and technicians in the United States, all of which the Company believes are potential users of the Mobile Assistant(R) Series and the Company's other products. There are many sources of savings available from use of the Mobile Assistant(R) Series and the Company's other products in maintenance and repair operations such as: less formal training is required for a similar level of performance, the time required for diagnostic and repair tasks is reduced as "just in time" refreshers and improved technical information can be provided, and personnel can address a wider range of complex tasks or products with the same level of basic training. While these savings can be realized in most industries, the Company anticipates that these savings will be most immediate and apparent in those industries that require a large investment in equipment and machinery, including the transportation, automotive, construction, power generation, health services, agriculture and the military. In industries such as construction or mining, the Company believes downtime on critical equipment can cost up to \$75,000 or more per day.

Accordingly, a reduction measured in minutes or hours of downtime in these industries can, in the Company's view, provide ample cost justification for a Mobile Assistant(R). The telecommunications industry is expected to be a prime candidate for mobile computing systems given the industry's complex technologies, increased competition and assets spread over a wide geographic area. The Mobile Assistant(R) can provide needed knowledge to workers on the top of a telephone pole, at a remote relay station or in a conduit tunnel. Crew locations can be monitored and coordinated in the field with the Mobile Assistant(R) through optional global positioning system technology. Crews at remote locations can consult with experts using two-way audio and/or video communications.

Healthcare. According to the National Center for Health Statistics, in the United States spent approximately 13.6% of the U.S. Gross Domestic Product, or approximately \$1 trillion, on healthcare, with an estimated 25% of such expenses consumed by administrative expenses. According to the National Center for Health Statistics, United States, 1994, the United States has over 6,000 hospitals and over 540 health maintenance organizations. According to the United States Department of Labor, in 1994 there were approximately 4,714,000 healthcare workers in the United States. The Company believes that many of the current processing and data systems used in healthcare, both in institutions and in the field, are not well developed or integrated and that hands-free mobile computing systems could reduce expenses and increase efficiency in this industry. The Mobile Assistant(R) is believed to present great potential in field medical operations by providing on-board and remote diagnostics, audio and/or video communication with doctors for emergency procedures, and transmission of locations for helicopter pickup through global positioning systems integrated into the Mobile Assistant(R). Another anticipated benefit of the Company's hands-free mobile computing technologies is that fewer healthcare personnel will be needed to perform complex tasks. By providing remote delivery of medical information, the Company's hands-free mobile computing systems can become a key component within both managed care and telemedicine organizations, which are two key submarkets developing within the healthcare industry.

Public Sector. The Company has demonstrated the ability of its technology to aid in law enforcement, fire protection, emergency services and control of national borders. The North American distributor of Xybernaut's MA IV, EnPointe, has demonstrated the success of establishing purchasing schedules for most significant city, state and municipal agencies, thus making the technology readily available.

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Education. The Company believes that its mobile computing systems are well suited for educational applications. The Mobile Assistant(R) is especially suited for hands-free applications, such as laboratory work, field research and dissections and has the potential to serve as a mobile student workstation. In addition, it can provide an ideal computing and control platform for special education and handicapped needs.

Military. There are several potential military applications for the Company's hands-free mobile computing systems, including intelligence, maintenance and field operations. The military has long been an early adopter of advanced weapons technologies and, as a result, was one of the first sectors to experience problems with the ability of personnel to maintain, diagnose and repair the advanced technology employed in both weapons and equipment. These problems have been compounded by the downsizing of the United States military and related budget constraints. As a result, even greater pressure will be placed upon the military to maintain its equipment and weapons platforms with fewer personnel. The Company believes that most of the estimated 700,000 military maintenance personnel in the United States could be made more efficient and productive by the Company's hands-free mobile computing systems.

The United States military's increasingly sophisticated weapon systems require volumes of operational and technical manuals and have dramatically increased the importance of maintenance. The United States Army has purchased the Mobile Assistant(R) and has tested its use in the maintenance and repair of the AH64 Apache Attack helicopter. The Apache can send and receive maintenance data via an industry standard electrical interface which can be read by an optional interface for the Mobile Assistant(R). Operating and performance data can be downloaded directly from the Apache and the Mobile Assistant(R) can be used to diagnose existing and potential maintenance and repair problems. The Company anticipates that manufacturers of complex military and commercial equipment increasingly will incorporate integrated data collection and transmission capabilities into their technologies to reduce downtime, repair and maintenance related costs.

The ability to deliver information to soldiers in combat field operations is the focus of several development programs sponsored by the United States Army. The Army has been conducting simulated combat maneuvers using body-worn computing components, including those provided by the Company, to

determine effectiveness for use in coordinating troop locations and movements, determining enemy locations, and using global positioning systems to provide coordinates for artillery, helicopter pickup and air support.

The Company has already sold many systems into the US Army and Navy, and expects that its sales partners will sell heavily into the armed services both in the USA and overseas.

Marketing

Because the Company's products are frequently combined with products from other manufacturers to form integrated information systems, the Company believes that it is more effective to sell principally through Distributors, Systems Integrators, Industrial and Commercial Equipment Manufacturers, Independent Software Vendors and VARs with defined market niche expertise and presence as well as to end users. In preparation for the introduction of the MA IV, the Company has and is negotiating terms with several specialized distributors for higher volume distribution of the MA IV. The Company believes that by forming relationships with these partners we can gain entry to many various sub-markets and types of end users, and serve customers or have in-place sales and distribution channels that identify new customers and sales opportunities. The Company can then reach end users more rapidly in a variety of industries.

To try to ensure outstanding partner performance, the Company has offered detailed in-house training sessions to prepare and update personnel for field sales and training. In addition, the Company is developing comprehensive sales and operations manuals to be used by these channels and end-users.

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The Company's marketing and sales employees are responsible for implementing direct marketing plans and sales programs, coordinating sales activities with sales and marketing and service partners. All fulfillment will be accomplished through distribution partners, regardless of which entity makes the actual sales.

License Granted to the Company by Data Disk

During 1997, the Company entered into a series of agreements with Data-Disk Technology, Inc., a Virginia-based company, that produces a memory product known as the Data Disk that consists of a non-volatile memory chip encapsulated in a rugged polymer casing slightly smaller than a soldier's "dogtag" that is highly resistant to temperature and environmental conditions. The Company's management believes that the Data Disk provides an ideal storage medium for body-worn computer applications, especially those that involve a large number of people, inspection sites or equipment. These tags can be used to store information such as medical history, repair history or other data unique to an individual or piece of equipment and from which information can be read by inserting the tag into a reader that fits in the existing PC card slots on all models of the Mobile Assistant(R). The U.S. Department of Defense is evaluating the Data Disk and competing technologies to replace the current system of stamped metal dogtags for soldiers. Under the agreements with Data Disk, the Company received an exclusive, perpetual worldwide license to use and sell present and future Data Disk technology for user-supported (wearable) computing applications.

Key Suppliers

The Company has entered into supplier relationships with Sony Digital Products and Shimadzu, among others, for the production of the MA IV system. (See "--Production"). The Company has designed a proprietary HMD that is being manufactured by Greenway Engineering using purchased and fabricated parts. Greenway was contracted to purchase and manage parts and components inventory, manufacture computer boards, and assemble and test the HMD of the Mobile Assistant(R), as well as obtain Federal Communications Commission certification for the Mobile Assistant(R) system.

The Company has also entered into design, production, supply and support agreements with many companies, in the USA and overseas, in order to complete its wearable line of computers. They include Fujitsu, Sony Digital Products, Hitachi, Shimadzu, JAE, Toshiba, Moli Energy, IBM, Texas Instruments, the SBS, etc.

The Company currently has subcontracted the manufacture of the body-worn computing unit, headset and battery portions of the 133P to third-party vendors. These components are assembled and integrated with the software applications for the Mobile Assistant(R) at the Company's headquarters.

Although the Company believes there are multiple sources for many parts and components, the Company currently depends heavily on its current suppliers.

While management believes that the Company could adapt to any supply interruptions, such occurrences could necessitate changes in product design or assembly methods for the Mobile Assistant(R) Series and cause the Company to experience temporary delays or interruptions in supply while such changes are incorporated. Further, because the order time for certain components may range up to approximately three months, the Company also could experience delays or interruptions in supply in the event the Company is required to find a new supplier for any of these components. Any disruptions in supply of necessary parts and components from the Company's key suppliers could have a material adverse effect on the Company's results of operations. Any future shortage or limited allocation of components for the Mobile Assistant(R) could have a material adverse effect on the Company.

Production

The Company has a manufacturing agreement with Sony Digital Products, a subsidiary of Sony Corporation based in Nagano, Japan, for the manufacture of the MA IV, which is scheduled to begin full production in the quarter ending December 31, 1998. Shimadzu Corporation, a supplier of head-mounted displays and other commercial technology products based in Kyoto, Japan, has been engaged by the Company

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to develop and manufacture a color HMD for use with the MA IV. Most of the parts and components for the Mobile Assistant(R) are off-the-shelf PC components that are available in high quantity from multiple vendors. The Company currently uses a monochrome Active Matrix Liquid Crystal Display ("AMLCD") from one supplier in its HMD and has been notified by that supplier that the monochrome AMLCD has been discontinued and is being replaced by a color AMLCD. The Company's management believes that there are sufficient quantities available of this monochrome AMLCD to meet currently forecast requirements for the 133P system until the MA IV system is introduced. If the start of full-scale production of the MA IV model of the Mobile Assistant(R) is delayed past the quarter ending December 31, 1998, such delay will have an adverse effect on revenues for the twelve months ending December 31, 1998. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Warranties

The Company currently provides customers with a parts and labor warranty for one year. Warranty services for the 133P are provided by Matrix and warranty services for the Company's HMD are provided by Greenway Engineering, except for the AMLCD, which is provided by its manufacturer. Warranty services for the MA IV Series is an integrated offering by several vendors. Our distribution partners are responsible for levels one and two service. The Company intends to pass on Level 3 maintenance and call-center support to a 3rd party service firm.

Competition

The Company anticipates that ultimately it will face widespread competition from other portable computing systems manufacturers. Several other companies are engaged in the manufacture and development of body-mounted or hand-held computing systems which can also compete with the Mobile Assistant(R) Series, including CDI, Teltronics, Inc. (a subsidiary of Interactive Solutions Inc.), ViA Inc., Texas Microsystems, Telxon, Norand, Raytheon and others. Personal digital assistants and laptop and notebook computers also are products that could compete against the Mobile Assistant(R) Series. Some of these computers are manufactured by major domestic and foreign computer manufacturers which possess far more resources than the Company and can be expected to compete vigorously with the Company for the market at which the Mobile Assistant(R) Series is directed. There can be no assurance the Company will be able to compete successfully against its competitors or that the competitive pressures faced by the Company will not adversely affect its financial performance. However, the Company considers entry by reputable, large computer manufacturers to be healthy for the marketplace in that it would bring legitimacy to the market in a more rapid fashion. The Company is also confident in its intellectual property position.

Intellectual Property

The Company relies on a combination of patent, trade secret, copyright and trademark laws and contractual restrictions to establish and protect its proprietary rights. The Company has entered into confidentiality and invention assignment agreements with its employees, and enters into non-disclosure agreements with its suppliers, VARs, OEMs and actual and potential customers to limit access to and disclosure of its proprietary information. The Company has registered its Mobile Assistant(R) and Xybernaut(R) trademarks on the Principal Register of the United States Patent and Trademark Office ("Patent Office") and the patent and trademark offices in several foreign countries.

In April, 1994 U.S. patent number 5,305,244 ("hands-free, user-supported portable computers") (the "Patent") for the Mobile Assistant(R) Series was granted to the Company. This patent was previously assigned to the Company by several employees of the Company. In September 1995 and April 1996, the Company received separate reexamination notifications from the Patent Office, which reexaminations of the Patent were initiated as a result of a request from one of the Company's competitors.

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In November 1996, the Company filed a written response to the request for reexamination and preliminary rejection. The second re-examination has been concluded and the Patent Office indicated that the Company was successful in the reexamination and sent the Company a "Notice of Intent to Issue Reexamination Certificate" indicating that the Patent Office ruled in the Company's favor. Subsequently on September 23, 1997, the Patent Office issued the Reexamination Certificate to the Company indicating successful results for the Company in the second re-examination. Most of the Company's revenue for the twelve months ended December 31, 1997 and 1996 and the six months ended June 30, 1998 and 1997 were derived from products included within the scope of the patent.

The Company has notified several of its competitors of the existence of the Patent, which the Company's counsel believes may have been infringed by some of such competitors. The Company intends to take any and all appropriate measures, including legal action, necessary to maintain and enforce its rights under the Patent and other patents held by the Company and to recover any damages suffered as a result of any alleged infringement.

Since July 1996, the Company has filed twenty patent applications covering various aspects of computers in general and wearable computers in particular. Of these twenty applications, six additional patents have been issued, one patent has been allowed pending issuance and thirteen patents are pending. Most of these applications have also been filed in European countries, The People's Republic of China, Japan, Republic of Korea, Republic of China (Taiwan), Canada and Australia. All patents obtained by Company employees under pending and future applications have been and will be assigned to the Company under existing invention assignments.

Notwithstanding the foregoing, there can be no assurance that the Company's pending patent applications will issue as a patents, that any issued patent will provide the Company with significant competitive advantages or that challenges will not be instituted against the validity or enforceability of any patent held by the Company. The cost of litigation to uphold the validity and prevent infringement of patents can be substantial. There also can be no assurance that others will not independently develop similar or more advanced products, design patentable alternatives to the Company's products or duplicate the Company's trade secrets. The Company may in some cases be required to obtain licenses from third-parties or to redesign its products or processes to avoid infringement. The Company also relies on trade secrets and proprietary technology and enters into confidentiality agreements with its employees and consultants. The Company has implemented a trade secret management program to further protect the Company's trade secrets and proprietary information. There can be no assurance that the obligation to maintain the confidentiality of such trade secrets or proprietary information will not be breached by employees or consultants or that the Company's trade secrets or proprietary technology will not otherwise become known or be independently developed by competitors in such a manner that the Company has no practical recourse.

Research and Development

Research and development expenditures for the years ended December 31, 1997 and 1996 and the six months ended June 30, 1998 and 1997 were \$2,350,237, \$1,773,015, \$1,010,769 and \$1,196,319, respectively. These expenditures consist primarily of personnel engaged in the research and design of new hardware and software products, test components, consulting fees, equipment and purchase software costs required to conduct the Company's development activities.

Employees and Consultants

As of June 30, 1998, the Company had 30 full-time and nine part-time employees, and had consulting arrangements with ten individuals or firms for advice and assistance on selected technical and business issues. Of the Company's full-time employees, two are executive officers, eleven are technical and administrative support employees, five are engaged in research and development, four are engaged in assembly and testing and eight are engaged in sales and marketing. None of the Company's employees are represented by a union and management believes that the Company's relations with its employees are good.

The Company is a party to employment and consulting agreements with certain of its executive officers and directors. See "Management -- Employment Agreements; -- Consulting Agreements."

Properties

The Company's office and development facility consists of 18,642 square feet located at 12701 Fair Lakes Circle, Fairfax, Virginia. The Company's current lease is for a three-year term expiring September 30, 1998 and requires monthly rent of approximately \$26,000.

To minimize lodging expenses for visiting employees and consultants, the Company leases an apartment located at 4401 Sedgehurst Drive, #301, Fairfax, Virginia 22033 pursuant to a month-to-month lease requiring monthly rent of \$975. The Company must give at least 45 days prior written notice before termination of the lease. The Company also leases an apartment at 11842 Federalist Way for a twelve-month period ending November 30, 1998 with a monthly rent of \$1,099 and an apartment at 4705 Quiet Woods Lane for a twelve-month period ending July 6, 1999 with a monthly rent of \$1,016.

During the year ended December 31, 1997, the Company leased approximately 650 square feet of office space at FM Building 102, 7-39-5 Nishikamata, Ohta-ku, Tokyo 144, Japan, for use as its Far East representative office. The initial lease term is for two years ending April 1999 at a base rent of approximately \$1,700 per month and is renewable at the Company's option for an additional two year period. Subsequent to year-end, the Company terminated this lease and moved its offices to Wakadayashi Building, 5-12-6 Kita-Shinagawa, Shinagawa-ku, Tokyo 141, Japan.

Legal Proceedings

On March 19, 1998, Matrix Corporation, with whom the Company had entered into an agreement in June 1997 (the "June Agreement"), filed a summons against the Company in the United States District Court, Eastern District of North Carolina, alleging that: Matrix has been damaged by a purported breach of the December 1997 Agreement (the "December Agreement") by the Company; that the Company should return all goods shipped by Matrix under both the June Agreement and the December Agreement; that the Company did not intend to comply with the December Agreement and therefore the governing contract between the two entities should revert to the June Agreement. In addition, this summons requests that any damages incurred by Matrix as a result of this purported breach of contract be trebled. On August 6, 1998, the Court rendered an Order dismissing all of Matrix's claims, except for the breach of contract claim under the December Agreement. On September 9, 1998, the Company filed an answer which denies the material allegations of the complaint, and asserts a counterclaim alleging that Matrix failed to perform to the requirements of the December Agreement and that Xybernaut has been damaged by this failure to perform. While there can be no assurance of the outcome of this legal proceeding, the Company's management believes that the remaining claim by Matrix is groundless and that the impact of this legal proceeding will not be materially adverse to the Company's operations. The maximum amount payable by the Company under the December Agreement if Matrix performs defined tasks is approximately \$250,000 and the maximum amount of inventory that could be assumed by the Company under the December Agreement is approximately \$600,000.

MANAGEMENT

Directors and Executive Officers

The officers and directors of the Company, their ages and present positions held with the Company are as follows:

<TABLE>
<CAPTION>

Name	Age	Present Position with the Company
Edward G. Newman	54	President, Chief Executive Officer and Chairman of the Board of Directors
George Allen, Esq.	46	Director
Eugene J. Amobi	52	Director
Keith P. Hicks, Esq.	75	Director

Steven A. Newman, M.D.	52	Director and Vice Chairman of the Board of Directors
Phillip E. Pearce	69	Director
James J. Ralabate, Esq.	70	Director
Lt. Gen. Harry E. Soyster (Ret.)	62	Director
Kaz Toyosato	54	Executive Vice President and Director
Martin Eric Weisberg, Esq.	47	Director
Dr. Edwin Vogt	65	Director
Maarten Heybroek	56	Chief Operating Officer and Chief Financial Officer

</TABLE>

The Company Board of Directors is divided into three different classes. At each annual meeting of stockholders of the Company, one class of directors will be elected to succeed those directors in the class whose terms then expire, for terms expiring at the third succeeding annual meeting of stockholders. The following is a brief summary of the background of each director and executive officer of the Company:

Class I Directors

Keith P. Hicks, Esq. has been a director of the Company since July 1994 and currently is a principal in C&H Properties and the owner of Hicks Bonding Co., Hicks Auctioneering Co. and Hicks Cattle Company. Mr. Hicks is a graduate of the University of Denver (B.A. 1954) and LaSalle University School of Law (L.L.B. 1969).

Kaz Toyosato joined the Company in October 1996 as Executive Vice President of Asian Operations. Mr. Toyosato is responsible for overseeing the Company's operations in Asia, including Japan. Prior to joining the Company, Mr. Toyosato spent 27 years with Sony Corporation in Japan where his last position was the Vice President of Sony USA. He previously served as product manager for the Sony Walkman product line, as well as Sony's 8mm video camcorder and its battery line of products.

Martin Eric Weisberg, Esq., who currently serves as Secretary of the Company, is a partner of the law firm, Parker Chapin Flattau & Klimpl, LLP, which serves as general counsel to the Company. Mr. Weisberg specializes in the areas of securities, mergers and acquisitions, financing and international transactions and has been in the private practice of law for 23 years. Mr. Weisberg is a summa cum laude graduate of Union College (B.A. 1972) and received his law degree from The Northwestern University School of Law (1975), where he graduated summa cum laude, was Articles Editor of the Law Review and was elected to the Order of the Coif. Mr. Weisberg also attended The London School of Economics and Political Science.

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Class II Directors

Eugene J. Amobi has been a director of the Company since January 1996. Since 1983, Mr. Amobi has been President, a director and a principal stockholder of Tech International, Inc. ("Tech International"), which provides engineering, technical support and consulting services to government and domestic and international commercial clients. Mr. Amobi has been president and director of Tech International of Virginia Inc. ("Tech Virginia"), the Company's wholly-owned subsidiary, since its spin-off from Tech International. Prior to 1983, Mr. Amobi was a Senior Engineer with E.I. DuPont de Nemours and a Managing Director of Stanley Consultants, an international engineering consulting firm. Mr. Amobi is a graduate of The Technion, Israel Institute of Technology (B.S. 1969), Princeton University (M.S. 1970) and Syracuse University (M.B.A. 1973).

Phillip E. Pearce has been a director of the Company since October 1995. Mr. Pearce has been an independent business consultant with Phil E. Pearce & Associates, Chairman and Director of Financial Express Corporation since 1990 and since 1988 has been a principal of Pearce-Henry Capital Corp. Prior to 1988 Mr. Pearce was Senior Vice President and a director of E.F. Hutton, Chairman of the Board of Governors of the National Association of Securities Dealers, a Governor of the New York Stock Exchange and a member of the Advisory Council to the United States Securities and Exchange Commission on the Institutional Study of the Stock Markets. Mr. Pearce also is a director of RX Medical Services, Inc., an operator of medical diagnostic facilities and clinical laboratories, InfoPower International, Inc., a software development company and StarBase Corporation, a software development company, and United Digital Networks, Inc., a provider of voice and data long distance services. Mr. Pearce is a graduate of the University of South Carolina (B.A. 1953) and attended the Wharton School of Investment Banking at the University of Pennsylvania.

Lt. Gen. Harry E. Soyster (Ret.) has been a director of the Company since January 1995. He is currently Director of Washington Operations and Vice President of International Operations of Military Professional Resources, Incorporated. From 1988 until his retirement in 1991, Lieutenant General Soyster (Ret.) was the Director of the United States Defense Intelligence Agency. Prior

to that time, he was Commander of the United States Army Intelligence and Security Command and a Deputy Assistant Chief of Staff for Intelligence, Department of the Army. Lieutenant General Soyster (Ret.) is a graduate of the United States Military Academy at West Point (B.S. 1957), Penn State University (M.S. 1963), the University of Southern California (M.S. 1973) and the National War College (1977).

Dr. Edwin Vogt was appointed a director on September 28, 1998 and has been a consultant to the Company since 1996. Mr. Vogt joined IBM in 1961 as Development Programmer and worked in the fields of hardware development, holding 28 patents, as well as software development. As manager he was responsible for hardware projects (IBM /360, /370, 433x) as well as various software projects (a.o. voice recognition products) before being appointed Director as manager of several Hardware and Software Product Development Laboratories. As IBM Software Group Executive he held the worldwide responsibility for the development and marketing of IBM Workflow products and Reengineering tools until retiring from IBM end of 1995. In early 1996 he was appointed Director for the SBS association (Softwarezentrum Boeblingen / Sindelfingen e.V.) and, since then, has grown this center to 39 member companies with over 200 experts, predominantly working in high-growth areas such as Internet, Workflow, Process Automation, Multimedia. Dr. Vogt is a graduate of the University of Stuttgart with an M.S. in Electrical Engineering and Mathematics in Theoretical Electrical Engineering.

Current Class III Directors

George Allen, Esq. is a partner of the law firm of McGuire Woods Battle & Boothe, LLP. Mr. Allen was Virginia's 67th governor from 1994-1998, during which period state taxes were cut by \$1 billion, \$14 billion in new investments were made in the state resulting in 300,000 net new private sector jobs. Mr. Allen's term in office also was noted for comprehensive reforms in primary and secondary education, the abolition of parole, reform of the juvenile justice systems and the replacement of the welfare system with reforms which promote work ethic and personal responsibility. Prior to serving as Governor of Virginia, Mr. Allen was a member of the

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U.S. House of Representatives in 1991 and a member of the Virginia House of Delegates from 1983-1991. Mr. Allen is a member of the Board of Directors of Commonwealth Biotechnology, Inc. Mr. Allen is a graduate of the University of Virginia at Charlottesville (B.A. 1974), with distinction, and received his law degree from the University of Virginia at Charlottesville (J.D. 1977).

Edward G. Newman has been the Company's President since March 1993, Chief Executive Officer and Chairman of the Board of Directors since December 1994, and a director since 1990. Mr. Newman served as Treasurer of the Company from 1993 to 1994. From 1984 to 1992 Mr. Newman was President of ElectroTech International Corporation, a software consulting firm. From 1973 to 1981 Mr. Newman was employed by Xerox Corporation in several management positions in office systems strategy, legal systems and international financial systems. Mr. Newman served with the Central Intelligence Agency from 1966 to 1972. Mr. Newman also has been an Executive Vice President of Tech International since 1990, and a director and Chief Executive Officer of Tech Virginia since 1994. See "Certain Transactions." Mr. Newman is a graduate of the University of Maryland (B.A. 1971) and the University of New Haven (M.B.A. 1984). Mr. Newman is the brother of Steven A. Newman, M.D., a director of the Company.

Steven A. Newman, M.D. has been a director of the Company since January 1995, a consultant to the Company since January 1996 and Vice Chairman of the Board of Directors since August 1997. See "Business - Employees and Consultants." Dr. Newman was Executive Vice President and Secretary of the Company from December 1994 through October 1995. Dr. Newman also provides business, management and administrative consulting services to various medical and business groups. Dr. Newman was President and Chief Executive Officer of Fed American, Inc., a mortgage banking firm, from 1988 to 1991. Dr. Newman has been a director of Tech Virginia since 1994. See "Certain Transactions." Dr. Newman is a graduate of Brooklyn College (B.A. 1967) and the University of Rochester (M.D. 1972). Dr. Newman is the brother of Edward G. Newman, the Company's President, Chief Executive Officer and Chairman of the Board of Directors.

James J. Ralabate, Esq. has been a director of the Company since January 1995 and served as the Company's Secretary until August 1997. Mr. Ralabate has been in the private practice of patent law since 1982. Prior to that time, Mr. Ralabate was General Patent Counsel for Xerox Corporation, responsible for worldwide patent licensing and litigation, and an examiner for the Patent Office. Mr. Ralabate is intellectual property counsel to the Company, and is a graduate of Canisius College (B.S. 1950) and The American University (J.D. 1959).

All Directors of the Company hold office until the third annual meeting

of shareholders following their election or until their successors are elected and qualified. Officers are appointed to serve at the discretion of the Board of Directors. The Company has three committees, Compensation, Auditing and Nominating.

The functions of the Audit Committee include the nomination of independent auditors for appointment by the Board; meeting with the independent auditors to review and approve the scope of their audit engagement; meeting with the Company's financial management and the independent auditors to review matters relating to internal accounting controls, the Company's accounting practices and procedures and other matters relating to the financial condition of the Company; and to report to the Board periodically with respect to such matters. The Audit Committee currently consists of Keith P. Hicks, Dr. Steven A. Newman and Phillip E. Pearce.

The function of the Compensation Committee is to review and recommend to the Board of Directors the appropriate compensation of executive officers of the Company and to administer the 1996 Omnibus Stock Incentive Plan and the 1997 Stock Incentive Plan. The Compensation Committee currently consists of Dr. Steven A. Newman, Lt. Gen. Harry E. Soyster (Ret.) and Martin Eric Weisberg, Esq.

The function of the Nominating Committee is to select and recommend to the Board of Directors appropriate candidates for election to the Company's Board of Directors. The Nominating Committee currently consists of Dr. Steven A. Newman, Lt. Gen. Harry E. Soyster (Ret.) and Martin Eric Weisberg, Esq.

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The Company also has an Advisory Board which was established to provide council and support to the Board of Directors. The members of the Advisory Board are appointed by the Board of Directors. Its members currently include:

Lawrence Berk is currently Senior Managing Director of Brill Securities. He has been a money manager and has structured and advised companies on financings and strategic planning, having held executive positions with various investment banking firms, including Oppenheimer & Co. where he was a partner. Mr. Berk has also held many leadership roles in the entertainment business. He served as a member of the Board of the Actors Studio for 15 years where he produced plays; he was a founding Chairman of the Veterans Ensemble Theatre, a group of writers, actors and directors from the Vietnam war; he was on the Board of the Association of American Dance Companies; and he was a trustee of the Manhattan Theatre Club. Mr. Berk is a member of the Financial Investment Analyst Association and the Regional Investment Bankers Association.

Wayne Coleson is at present and since 1994 has been the President and a Director of Avalon Capital, Inc., a Director of Settondown Capital International, Ltd. and a Director of Manchester Asset Management, Ltd., each of which is an investment company which invests in and structures private placement transactions. Mr. Coleson is a founder of all three companies. During the last three years Mr. Coleson completed over 75 transactions resulting in \$500 million of investments. Prior to these activities Mr. Coleson was affiliated with Shoreline Pacific Institutional Finance, Laffer-Warren Investment Brokers and Lehman Brothers, during which period Mr. Coleson had extensive roles in structuring, evaluating, negotiating and raising capital for small to micro-cap companies in the United States and Europe. Mr. Coleson graduated from the University of Georgia in 1985 with a B.A. in Political Science.

Dr. Andrew Heller has been an advisor to the Board of Directors since 1995. Since 1989 Dr. Heller has been Chairman and Chief Executive Officer of Heller Associates, a consulting firm to high technology companies. From 1990 to 1993 Dr. Heller was Chairman and Chief Executive Officer of Hal Computer Systems, Inc., a software and hardware systems development company. From 1966 to 1989 Dr. Heller was employed by IBM (where he was the youngest person ever to be selected as an IBM Fellow) in a variety of positions including Corporate Director of Advanced Technology Systems, member of the Executive Committee on Technology, member of the Technical Review Board, and General Manager, Advanced Workstation Independent Business Unit. While at IBM, Dr. Heller created and ran the business unit that created the AIX (UNIX) operating system for IBM and the RISC RS/6000 family of workstations and servers, from which the current Power PC was developed. Dr. Heller is a director of Rambus, Inc., Cross/Z, Inc., Network Translation, Inc., EPR, Inc., Eco Instrumentation, Inc. and UDI Software, Inc. Dr. Heller has a three-year consulting agreement with the Company whereby Dr. Heller has agreed to provide strategic planning, business management, strategic product development and market and financial introduction services to the Company.

Maarten Heybroek has been an advisor to the Board of Directors since 1992. Since 1986, Mr. Heybroek has been employed by Citibank, as Chief of Staff and Controller for consumer banking activities in Central Europe and, most recently, as Director, Compliance and Risk Management for Citibank's United

States consumer banking operations. Prior to that time, Mr. Heybroek was Director, Finance-European Operations and then Director, Corporate Finance for Intergraph Corporation, a publicly-traded computer hardware and software firm, and with Xerox Corporation in a variety of financial and management positions. Mr. Heybroek is a graduate of Pace University.

Vice Admiral Stephan F. Loftus (ret.) retired from the United States Navy in May of 1994. Prior to that he served as the Deputy Chief of Naval Operations (Logistics). Vice Admiral Loftus held previous positions with the U.S. Navy as Commander, Fleet Air Mediterranean; Director, Office of Budget and Reports; and Director, Office of Program Appraisal. Vice Admiral Loftus presently serves as Executive Vice President of Quarterdeck Investment Partners, Inc. (specializing in merger/acquisitions) and The Spectrum Group (a strategic planning group). He consults for Lockheed Martin Corporation, SAIC, Johns Hopkins University - Applied Physics Lab, Systems Planning Corporation, and Global Planning Corporation. He is on the Board of Directors of AMSEC,

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Inc. and LLD, Inc., and serves as a member of the Logistics Panel for the Defense Science Board. Also, Admiral Loftus serves as the Chairman of the Board of Trustees at NMCCG Foundation.

General Richard H. Thompson (ret.) retired from the U.S. Army in 1987 after 43 years of service. His last assignment was as the Commander of the U.S. Army Material Command, an organization of 132,000 personnel at 171 locations worldwide with an annual budget in excess of \$35 billion. Since his retirement, General Thompson has served on the Board of Directors of several companies, has consulted with many others, and has participated as a member of several Study Groups for the National Academy of Sciences and the House of Representatives. He is currently the Chairman and Chief Executive Officer and actively engaged in the operations of three companies he has established: Thompson Delstar Inc., TMI Asia, and TDIS.

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EXECUTIVE COMPENSATION

The following sets forth the annual and long-term compensation for services in all capacities to the Company (i) for the fiscal year ended December 31, 1997, for the fiscal year ended December 31, 1996, for the nine month transitional year ended December 31, 1995 and the fiscal year ended March 31, 1995 of Edward G. Newman, the Company's President, Chief Executive Officer and Chairman of the Board of Directors, and (ii) for the fiscal years ended December 31, 1997 and December 31, 1996, and for the transitional year dated December 31, 1995 and the fiscal years ended March 31, 1995 of John P. Moynahan, the Company's former Senior Vice President, Chief Financial Officer, Treasurer and director. Mr. Moynahan resigned from his various positions with the Company effective June 3, 1998. No other officer of the Company received annual salary and bonus exceeding \$100,000 during the relevant periods.

<TABLE>

<CAPTION>

Name and principal position	Year	Annual compensation (1)		Long Term compensation awards (1)	
		Salary	Bonus	Options (Shares)	All other compensation
<S>	<C>	<C>	<C>	<C>	<C>
Edward G. Newman	1997	\$211,211 (1)	\$- 0 -	- 0 -	\$43,600 (2)
President and Chief Executive Officer	1996	\$149,635 (1)	\$- 0 -	- 0 -	\$- 0 -
and Chairman of the Board of	1995*	\$112,500	\$- 0 -	- 0 -	\$- 0 -
Directors	1995	\$ 68,750	\$- 0 -	- 0 -	\$- 0 -
John F. Moynahan	1997	\$142,083	\$- 0 -	- 0 -	\$15,465 (2)
Senior Vice President, Chief Financial	1996	\$139,688	\$- 0 -	- 0 -	\$- 0 -
Officer and Treasurer	1995*	\$105,000	\$- 0 -	- 0 -	\$- 0 -
	1995	\$ 64,167	\$- 0 -	200,000	\$- 0 -

</TABLE>

* Transitional year ended December 31, 1995.

(1) Compensation does not include (i) \$50,000 and \$50,084 paid to Frances C. Newman, wife of Edward G. Newman in 1997 and 1996, respectively, and (ii) \$87,314 paid by Tech of Virginia in 1997 and 1996, as payment of accrued salaries and expenses.

(2) Includes payment of non-accountable expense allowances and car allowances.

Options/SAR Grants in Last Fiscal Year

The following table sets forth information on grants of stock options during fiscal 1997 to executive officers and directors of the Company. All such options are exercisable to purchase shares of Common Stock.

<TABLE>

<CAPTION>

Name	Options granted (shares)	Percent of total options granted to officers/directors in year	Exercise or base price (\$/Share)	Expiration date
Steven A. Newman	50,000	18.5%	\$2.6125	January 2, 2007
Eugene J. Amobi	10,000	3.7%	\$2.8125	August 28, 2007
Keith P. Hicks, Esq.	10,000	3.7%	\$2.8125	August 28, 2007
Phillip E. Pearce	10,000	3.7%	\$2.8125	August 28, 2007
James J. Ralabate, Esq.	10,000	3.7%	\$2.8125	August 28, 2007

</TABLE>

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<TABLE>

<CAPTION>

Name	Options granted (shares)	Percent of total options granted to officers/directors in year	Exercise or base price (\$/Share)	Expiration date
Lt. Gen. Harry E. Soyster	10,000	3.7%	\$2.8125	August 28, 2007
Kaz Toyosato	50,000	18.5%	\$2.8125	August 28, 2007
Martin Eric Weisberg, Esq.	50,000	18.5%	\$1.6875	August 28, 2007
	10,000	3.7%	\$2.8125	August 28, 2007

</TABLE>

Fiscal Year-End Options/Option Values Table.

<TABLE>

<CAPTION>

Name	Number of Securities underlying unexercised options at fiscal year-end		Value of Unexercised in-the-money options at fiscal year-end (\$)	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Steven A. Newman	110,000	0	0	0
Eugene J. Amobi	60,000	0	0	0
Keith P. Hicks, Esq.	60,000	0	0	0
Phillip E. Pearce	60,000	0	0	0
James J. Ralabate, Esq.	60,000	0	0	0
Lt. Gen. Harry E. Soyster	60,000	0	0	0
Kaz Toyosato	50,000	0	0	0
Martin Eric Weisberg, Esq.	60,000	0	0	0

</TABLE>

None of the foregoing options were exercisable within 60 days of December 31, 1997.

The Company has no retirement, pension or profit sharing program for the benefit of its directors, officers or other employees, but the Board of Directors may recommend one or more such programs for adoption in the future.

Employment Agreements

The Company has entered into an employment agreement with Edward G. Newman which provides for a three-year term through December 31, 1998; initial annual base compensation of \$150,000 subject to a minimum annual increase to \$198,000 on January 1, 1997 and of at least the annual increase in the United States Consumer Price Index ("CPI") plus two percent annually thereafter, an annual cash bonus in an amount to be determined by the Board of Directors; and a \$2,000,000 life insurance policy payable to his designated beneficiaries. Mr. Newman received payments in 1997 for accrued salaries and expenses related to his employment with Tech Virginia and continues to provide services to Tech Virginia without contract at a fixed payment of \$1,000 per month with a \$650 automobile allowance per month. The employment agreement with Mr. Newman also entitles him to participate in all benefits which the Company may offer to its executive officers and employees, as a group. The Company anticipates that such benefits will include an automobile, health insurance and expense reimbursement. The employment agreement automatically renews for an additional three-year term unless terminated in writing by either party on or before October 31, 1998. The employment agreement also provides for termination at the option of Mr. Newman in the event of a change of control (which is defined as Mr. Edward Newman ceasing to serve as either the Chairman of the Company's Board of Directors or its President and Chief Executive Officer) and that upon any such termination Mr. Newman is entitled to at least two years of annual compensation under his employment agreement.

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Mr. Toyosato is employed pursuant to a three-year Employment Agreement with a term expiring on March 3, 2000. The Employment Agreement provides for an annual salary of \$153,575.23.

Consulting Agreements

The Company and Dr. Steven A. Newman entered into a Consulting Agreement dated as of January 1, 1996, as amended January 1, 1997. Pursuant to the Consulting Agreement, Dr. Newman will provide consulting services which includes, among other things, the review and assistance in the preparation of the Company's business strategies, assisting with the recruitment and hiring of key executives and provide advice regarding financing, contracting, management, overseas operations, strategic alliances and ventures. The annual consulting fee is \$150,000 payable on a monthly basis. The Consulting Agreement also provides for additional compensation, as determined by the Company's Compensation Committee, for services by Dr. Newman in connection with the successful completion of financings, mergers, acquisitions, dispositions, joint ventures and other material transactions. The term of the Consulting Agreement is four years terminating on December 31, 2000 unless renewed by the parties.

In 1996, the Company entered into a two-year consulting agreement with Victor J. Lombardi whereby Mr. Lombardi agreed to provide business development and marketing services to the Company in exchange for warrants which entitle Mr. Lombardi to purchase 100,000 shares of Common Stock at \$6.00 per share through December 31, 1999. For the year ended December 31, 1997, the Company recorded \$125,489 in expense connected with the issuance of these warrants.

Compensation of Directors

The Company currently does not pay or accrue salaries or consulting fees to outside directors for each board or committee meeting attended. While it is the Company's intention to establish such payments eventually, it does not currently anticipate doing so. Any payments when implemented will be comparable to those made by companies of similar size and stage. Directors receive a grant of options for 50,000 shares of Common Stock upon election to the Board of Directors and are entitled for each full year of service, commencing with those directors who were elected at the 1997 Annual Meeting, to receive a grant of options to purchase 10,000 shares of Common Stock which vests at the end of such year of service. The Company also has adopted an Omnibus Stock Incentive Plan and the 1997 Stock Incentive Plan in which directors are eligible to participate. See "Executive Compensation - Omnibus Stock Incentive Plan; -- 1997 Stock Incentive Plan." Steven A. Newman has entered into a consulting agreement with the Company. See "Executive Compensation --Consulting Agreements."

Omnibus Stock Incentive Plan

The 1996 Omnibus Stock Incentive Plan (the "1996 Incentive Plan") was adopted by the Company's Board of Directors effective January 1, 1996. The 1996 Incentive Plan provides for the granting of incentive stock options ("Incentive Stock Options") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), nonqualified stock options, stock appreciation rights ("SARs") and grants of shares of Common Stock subject to certain restrictions ("Restricted Stock") up to a maximum of 650,000 shares to officers, directors, employees and others. Incentive Stock Options can be awarded only to employees of the Company at the time of the grant. No options, SARs or

restricted stock ("Restricted Stock") may be granted under the 1996 Incentive Plan subsequent to December 31, 2006. To date, options have been granted to purchase all of the 650,000 shares of Common Stock reserved for issuance under the 1996 Incentive Plan.

The 1996 Incentive Plan is administered by the Compensation Committee of the Board of Directors (subject to the authority of the full Board of Directors), which determines the terms and conditions of the options, SARs and Restricted Stock granted under the 1996 Incentive Plan, including the exercise price, number of shares subject to the option and the exercisability thereof. Dr. Steven A. Newman, Lt. Gen. Harry E. Soyster (Ret.) and Martin Eric Weisberg, Esq. currently are the members of the Compensation Committee.

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The exercise price of all Incentive Stock Options granted under the 1996 Incentive Plan must equal at least the fair market value of the Common Stock on the date of grant. In the case of an optionee who owns stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company ("Substantial Stockholders"), the exercise price of Incentive Stock Options must be at least 110% of the fair market value of the Common Stock on the date of grant. The exercise price of all nonqualified stock options granted under the 1996 Incentive Plan shall be determined by the Compensation Committee. The term of any Incentive Stock Option granted under 1996 the Incentive Plan may not exceed ten years, or, for Incentive Stock Options granted to Substantial Stockholders, five years. The 1996 Incentive Plan may be amended or terminated by the Board of Directors, but no such action may impair the rights of a participant under a previously granted option.

The 1996 Incentive Plan provides the Board of Directors or the Compensation Committee the discretion to determine when options granted thereunder shall become exercisable and the vesting period of such options. Upon termination of a participant's employment or relationship with the Company, all options terminate and no longer are exercisable unless termination is due to death or disability, in which case the options are exercisable within one year of termination. The Compensation Committee has granted extensions of the period before which options may be exercised for certain terminated employees.

The 1996 Incentive Plan provides that upon a change in control of the Company, all previously granted options and SARs immediately shall become exercisable in full and all Restricted Stock immediately shall vest and any applicable restrictions shall lapse. The 1996 Incentive Plan defines a change of control as the consummation of a tender offer for 25% or more of the outstanding voting securities of the Company, a merger or consolidation of the Company into another corporation less than 75% of the outstanding voting securities of which are owned in aggregate by the stockholders of the Company immediately prior to the merger or consolidation, the sale of substantially all of the Company's assets other than to a wholly-owned subsidiary, or the acquisition by any person, business or entity other than by reason of inheritance of over 25% of the Company's outstanding voting securities. The change of control provisions of the 1996 Incentive Plan may operate as a material disincentive or impediment to the consummation of any transaction which could result in a change of control.

The 1996 Incentive Plan provides the Board of Directors or the Compensation Committee discretion to grant SARs in connection with any grant of options. Upon the exercise of a SAR, the holder shall be entitled to receive a cash payment in an amount equal to the difference between the exercise price per share of options then exercised by him and the fair market value of the Common Stock as of the exercise date. The holder is required to exercise options covering the number of shares, which are subject to the SAR so exercised. SARs are not exercisable during the first six months after the date of grant, and may be transferred only by will or the laws of descent and distribution.

The 1996 Incentive Plan also provides the Board of Directors or the Compensation Committee discretion to grant to key persons shares of Restricted Stock subject to certain limitations on transfer and substantial risks of forfeiture.

1997 Stock Incentive Plan

The 1997 Stock Incentive Plan (the "1997 Incentive Plan") was adopted by the Company's Board of Directors on April 10, 1997. The 1997 Incentive Plan provides for the granting of Incentive Stock Options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), nonqualified stock options, SARs and grants of shares of Common stock subject to certain restrictions (collectively, "Awards") up to a maximum of 1,650,000 shares to officers, directors, key employees and others. Incentive Stock Options can be awarded only to employees of the Company at the time of the grant. No ISO may be granted under the 1997 Incentive Plan after April 9, 2007.

The 1997 Incentive Plan is administered by the Board of Directors or a Committee of the Board of Directors, which determines the terms and conditions of the Awards granted under the 1997 Incentive Plan, including the exercise price, number of shares subject to the option and the exercisability thereof. Dr. Steven A. Newman, Lt. Gen. Harry E. Soyster (Ret.) and Martin Eric Weisberg, Esq. currently are the members of the Committee.

The exercise price of all Incentive Stock Options granted under the 1997 Incentive Plan must equal at least the fair market value of the Common Stock on the date of grant. In the case of Substantial Stockholders, the exercise price of Incentive Stock Options must be at least 110% of the fair market value of the Common Stock on the date of grant. The exercise price of all nonqualified stock options granted under the 1997 Incentive Plan shall be determined by the Compensation Committee. The term of any Incentive Stock Option granted under the 1997 Incentive Plan may not exceed ten years, or, for Incentive Stock Options granted to Substantial Stockholders, five years. The 1997 Incentive Plan may be amended or terminated by the Board of Directors, but no such action may impair the rights of a participant under a previously granted option.

The 1997 Incentive Plan provides the Committee the discretion to determine when options granted thereunder shall become exercisable and the vesting period of such options. Upon termination of a participant's employment or relationship with the Company, options may be exercised only to the extent exercisable on the date of such termination (within three months), but not thereafter, unless termination is due to death or disability, in which case the options are exercisable within one year of termination.

The 1997 Incentive Plan provides the Committee discretion to grant SARs to key employees, consultants and directors. Promptly after exercise of a SAR the holder shall be entitled to receive in chase, by check or in shares of Common Stock, an amount equal to the excess of the fair market value on the exercise date of the shares of Common Stock as to which the SAR is exercised over the base price of such shares, which shall be determined by the Committee

The 1996 Incentive Plan also provides the Committee discretion to grant to key persons shares of restricted stock subject to certain contingencies and restrictions as the Committee may determine.

As of December 31, 1997 a total of 1,627,430 options were outstanding. Each of the outstanding options has an exercise price at least equal to the fair market value of the Common Stock on the date of grant with the exception of 80,000 shares which are subject to acquisition by an officer of the Company and 20,000 shares which are subject to acquisition by an employee of the Company at \$0.01 per share over the period 1995 through 1999. As of December 31, 1997, there were no SARs outstanding and there has been one grant of Restricted Stock of 10,000 shares of Common Stock to a former officer of the Company.

Escrowed Shares

As a condition to the Company's initial public offering (the "IPO"), Royce Investment Group, the Representative of the several underwriters (the "Representative"), required certain of the Company's stockholders to deposit a total of 1,800,000 shares of Common Stock (the "Escrowed Shares"), in escrow pursuant to an escrow agreement with Continental Stock Transfer & Trust Company, the escrow agent and the Representative. Of such Escrowed Shares, 1,707,210 shares are owned by officers and directors of the Company. The Escrowed Shares are subject to incremental release to the depositing stockholders based upon the Company's total revenues and net earnings (loss) for the 12-month periods ending September 30, 1997, 1998 and 1999. The Escrowed Shares will be released in the amounts set forth below only upon the achievement by the Company of the following Performance Targets:

- 300,000 shares if the Company achieves gross revenues of at least \$20,000,000 and a net loss, if any, not in excess of \$500,000 for the 12 months ending September 30, 1997;

- 750,000 shares if the Company achieves gross revenues of at least \$45,000,000, and earnings per share of at least \$1.00 for the 12 months ending September 30, 1998; and

- 750,000 shares if the Company achieves gross revenues of at least \$90,000,000 and earnings per share of at least \$1.25 for the 12 months

ending September 30, 1999.

Notwithstanding the foregoing, if at any time the closing bid price of the Common Stock reported on The Nasdaq SmallCap Market equals or exceeds \$11.00 per share for 25 consecutive trading days or for 30 out of 35 consecutive trading days (the "Nasdaq Price Target") during the period ending September 30, 1999, all Escrowed Shares then remaining in escrow will be released from the escrow and returned to the stockholders.

The Escrowed Shares will be subject to incremental release only in the event the Company achieves the Performance Targets in the 12 months ending September 30, 1997, 1998 and/or 1999. In addition, upon achieving the Nasdaq Price Target at any time during the period ending on or prior to September 30, 1999 all then Escrowed Shares will be released. If the Performance Targets are not met in any of the relevant 12-month periods (and the price of the Common Stock has not met or exceeded the price described above prior to the expiration of the applicable 12-month period), the Escrowed Shares in the amounts stated above will be returned to the Company and canceled. Pursuant to such agreement, 300,000 shares of the Company's Common Stock have been returned to the Company and canceled for failure to meet the required Performance Target for the 12 months ending September 30, 1997. The earnings per share calculation will be based on the fully diluted earnings per share, but excluding shares issued pursuant to the Unit Purchase Option granted to the Representative, extraordinary items, or any compensation expense charged to the Company related to the release of the Escrowed Shares. The determination of earnings per share will be made in accordance with generally accepted accounting principles and will be based on the financial statements of the Company filed pursuant to the Securities Exchange Act of 1934, as amended. Escrowed Shares are not transferable or assignable although they may be voted by the holder.

The Performance Targets and the Nasdaq Price Target were determined by negotiation between the Company and the Representative and do not imply or predict any future performance by the Company. The market value of any Escrowed Shares held by officers, employees or consultants at the time they are released will be deemed to be additional compensation expense to the Company. Upon such an occurrence the Company will recognize a potentially material charge to income which could reduce or eliminate earnings, if any. The amount of compensation expense recognized by the Company will not affect the Company's total stockholders' equity or working capital.

Given the expected start of volume production in the current quarter, the Company's management believes that it is likely that the Company's gross revenues and allowable losses will not meet the Performance Targets for the 12-month period ending September 30, 1998. Accordingly, the release of the Escrowed Shares for this period is only likely if the stock price equals or exceeds \$11.00 for 25 consecutive trading days or 30 out of 35 consecutive trading days prior to September 30, 1998. If conditions are not met for release from escrow, then 750,000 Escrowed Shares of stock will be returned to the Company on September 30, 1998 and canceled, resulting in no earnings impact and a commensurately lower number of outstanding shares.

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PRINCIPAL SHAREHOLDERS

The following table sets forth as of September 24, 1998, certain information regarding the ownership of voting securities of the Company by each stockholder known to the management of the Company to be (i) the beneficial owner of more than 5% of the Company's outstanding Common Stock, (ii) the directors of the Company, (iii) the executive officers named in the Summary Compensation Table herein under "Executive Compensation" and (iv) all executive officers and directors as a group. The Company believes that the beneficial owners of the Common Stock listed below, based on information furnished by such owners, have sole investment and voting power with respect to such shares.

<TABLE>

<CAPTION>

Name (1) - - - - -	Amount of Shares Beneficially Owned ----- <C>	Percentage Owned ----- <C>
Edward G. Newman	3,771,721 (2)	18.0%
Dr. Steven A. Newman.....	1,683,897 (3)	8.0%
George Allen.....	----	*
Eugene J. Amobi.....	360,000 (4)	1.7%
Keith P. Hicks, Esq.....	414,171 (4)	2.0%
Phillip E. Pearce.....	60,000 (4)	*
James J. Ralabate, Esq.....	108,121 (4)	*
Jacques Rebibo.....	197,500 (5)	*

Lt. Gen. Harry E. Soyster (Ret.).....	84,061 (4)	*
Kaz Toyosato	50,000 (6)	*
Martin Eric Weisberg, Esq.....	60,000 (4)	*
Officers and directors (13 persons).....	7,135,556 (7)	32.2%

</TABLE>

- (1) The address for Mr. Edward G. Newman and Dr. Steven A. Newman is 12701 Fair Lakes Circle, Suite 550, Fairfax, Virginia 22033; the address for Mr. Allen is 1 James Center, 901 East Cary Street, Richmond, Virginia 23219; the address for Mr. Amobi is 100 Jade Drive, Wilmington, Delaware 19810; the address for Mr. Hicks is 4121 Roberts Road, Fairfax, Virginia 22032; the address for Mr. John P. Moynahan is 12303 Blair Ridge Road, Fairfax, Virginia 22033; the address for Mr. Pearce is 6624 Glenleaf Court, Charlotte, North Carolina 28270; the address for Mr. Ralabate is 5792 Main Street, Williamsville, New York 14221; the address for Mr. Rebibo is 7216 Dulany Drive, McLean, Virginia 22101; the address for Lt. Gen. Soyster (Ret.) is 1201 E. Abingdon Drive, Suite 425, Alexandria, Virginia 22314; the address for Mr. Toyosato is Kita-Shinagawa 5-12-6, Wakabayashi Bldg. 2F, Shinagawa-Ku, Tokyo Japan 141-0001; and the address for Mr. Weisberg is 1211 Avenue of the Americas, New York, New York 10036.
- (2) Excludes 200,000 shares of Common Stock beneficially owned by an irrevocable trust for Mr. Newman's children and 747,753 shares of Common Stock beneficially owned by Mr. Newman's wife, Francis C. Newman. Mr. Newman disclaims beneficial ownership of all such shares.
- (3) Includes 110,000 shares of Common Stock issuable upon exercise of currently exercisable options. Excludes 100,000 shares of Common Stock beneficially owned by a trust for the benefit of Dr. Newman's children and 57,800 shares of Common Stock owned by a trust for the benefit of two relatives of Dr. Newman. Dr. Newman disclaims beneficial ownership of such shares.
- (4) Includes 60,000 shares of Common Stock issuable upon exercise of currently exercisable options.

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- (5) Mr. Rebibo served as a director of the Company through August 28, 1997. His holdings include 10,000 shares of Common Stock issuable upon exercise of currently exercisable options.
- (6) Includes 50,000 shares of Common Stock issuable upon exercise of currently exercisable options.
- (7) Includes 580,250 shares of Common Stock issuable upon exercise of currently exercisable options. Also includes the holdings of Frances C. Newman and Jeffrey Pagano, two additional key executives of the Company, who hold, respectively, 797,753 shares of Common Stock (including 50,000 shares of Common Stock issuable upon currently exercisable options) and 250 shares of Common Stock.

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CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In connection with transactions described below, the Company did not secure an independent determination of the fairness and reasonableness of such transactions and arrangements with affiliates of the Company. In each instance described below, the disinterested directors (either at or following the time of the transaction) reviewed and approved the fairness and reasonableness of the terms of the transaction. The Company believes that each transaction was fair and reasonable to the Company and on terms at least as favorable as could have been obtained from non-affiliates. Transactions between any corporation and its officers and directors are subject to inherent conflicts of interest.

Tech International and Tech Virginia

Since December 1992, the Company has maintained various business relationships with Tech International and since 1994, with Tech Virginia. Tech International operates a computer software and consulting business. Until December 30, 1994, Tech International's Virginia operations were conducted through its Virginia business unit. In December 30, 1994, Tech International spun-off the Virginia business unit (the "Spin-Off") as Tech Virginia. Edward G.

Newman, a principal stockholder, director and the Chairman, President and Chief Executive Officer of the Company and Steven A. Newman and Eugene J. Amobi, directors of the Company, were the stockholders, and continue as officers and directors of Tech Virginia. Eugene J. Amobi is the sole director and stockholder of Tech International.

Management Personnel Agreements with Tech Virginia

Messrs. Edward G. Newman, Steven A. Newman and Eugene Amobi each had employment agreements with Tech Virginia under which each of them was entitled to a salary and each was eligible to receive certain bonuses. The agreements with Messrs. Edward G. Newman and Steven A. Newman required each of them to devote only reasonable time and attention to Tech Virginia, provided their activities for Tech Virginia did not interfere with their obligations to the Company. Upon the acquisition of Tech Virginia by the Company, such employment agreements were terminated by agreement with Messrs. Newman, Newman, and Amobi. Messrs. Newman, Newman and Amobi have continued to provide services to Tech Virginia since the acquisition without contract but under similar terms and conditions as their terminated agreements.

During fiscal 1997, the Company accrued, but did not pay, approximately \$97,800, respectively, in salaries and automobile allowances payable to Eugene Amobi, a director of the Company, for services provided to Tech Virginia. As of December 31, 1997, the total amount accrued and owed for such items to Mr. Amobi was approximately \$215,000, which was reduced by \$25,000 paid to an entity affiliated with Mr. Amobi after December 31, 1997.

Consulting Agreement

Steven A. Newman has entered into a consulting agreement with the Company. See "Executive Compensation - Consulting Agreements."

Legal Services

James J. Ralabate, Esq. was paid \$68,031 and \$275,548 in fees and disbursements for legal services rendered to the Company during fiscal 1996 and fiscal 1997, respectively.

Parker Chapin Flattau & Klimpl, LLP, the law firm where Martin Eric Weisberg, Esq. is a partner, was paid \$5,179 and \$137,346.15 in fees and disbursements for legal services rendered to the Company during fiscal 1996 and fiscal 1997, respectively.

SELLING STOCKHOLDER

The Shares being offered for resale by the Selling Stockholder are issuable to the Selling Stockholder pursuant to the Financing Arrangement between the Company and the Selling Stockholder. See "Financing Arrangement." The following table sets forth certain information regarding the ownership of shares of Common Stock by the Selling Stockholder assuming the sale by the Company of up to approximately \$10,100,000 of Common Stock under the Financing Arrangement, and as adjusted to reflect the sale of the Shares. The information in the table concerning the Selling Stockholder who may offer Shares hereunder from time to time is based on information provided to the Company by such stockholder. Information concerning the Selling Stockholder may change from time to time and any changes of which the Company is advised will be set forth in a Prospectus Supplement to the extent required. See "Plan of Distribution."

<TABLE>

<CAPTION>

	Shares of Common Stock Owned Prior to Offering (2)	Shares of Common Stock to be Sold	Shares of Common Stock Owned after Offering	
			Number	Percent
HSBC James Capel Canada, <S> Inc.	<C> ---	<C> 2,100,000	<C> 2,100,000	<C> 10.0%

</TABLE>

(1) Assumes that the Company will sell up to approximately \$10,100,000 of Common Stock to the Selling Stockholder under the Financing

Arrangement. See "Financing Arrangement."

- (2) As of the date of this Prospectus, the Selling Stockholder does not own any shares of the Company's Common Stock. If all of the shares offered hereby were purchased and held by the Selling Stockholder, it would hold 10.0% of the outstanding Common Stock of the Company.

The Selling Stockholder is not affiliated with the Company. The Selling Stockholder has not had any material relationship with the Company within the past three years.

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SHARES ELIGIBLE FOR FUTURE SALE

Sales of a substantial number of shares of the Company's Common Stock in the public market following this offering could adversely affect the market price of the Common Stock. Of the 24,155,566 shares of Common Stock that will be outstanding or registered for sale upon the completion of this offering, 22,391,426 will be freely tradeable without restriction or further registration under the Securities Act. This includes 19,194,366 shares of Common Stock which are issued and outstanding, 141,700 unissued shares of Common Stock registered in connection with the Series C Preferred Stock, 955,360 unissued shares of Common Stock registered in connection with the April 1998 Equity Line of Credit Private Placement and the 2,100,000 unissued shares of Common Stock registered in connection with this Financing Arrangement. The remaining 1,764,140 shares include 1,500,000 shares of Common Stock which are "Escrowed Shares" (see "Executive Compensation -- Escrowed Shares") and are subject to incremental release over a two-year period of certain share targets are met, and 264,140 shares of the Common Stock are "restricted securities" as that term is defined in Rule 144 promulgated under the Securities Act, and in the future may only be sold pursuant to an effective registration statement under the Securities Act, in compliance with the exemption provisions of Rule 144 or pursuant to another exemption under the Securities Act. In the absence of any agreement to the contrary, the outstanding restricted Common Stock could be sold in accordance with one or more other exemptions under the Securities Act (including Rule 144). Rule 144, as amended, permits sales of restricted securities by any person (whether or not an affiliate) after one year, at which time sales can be made subject to the Rule's existing volume and other limitations and by non-affiliates without adhering to Rule 144's existing volume or other limitations after two years. Future sales of substantial amounts of shares in the public market, or the perception that such sales could occur, could adversely affect the price of the shares in any market that may develop for the trading of such shares.

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DESCRIPTION OF SECURITIES

General

The authorized capital stock of the Company consists of 40,000,000 shares of Common Stock, par value \$.01 per share, and 6,000,000 shares of Preferred Stock, par value \$.01 per share. As of the date hereof, there are 20,958,506 shares of Common Stock and 281 shares of Series C Preferred Stock issued and outstanding. The Company currently has reserved 6,827,952 shares of Common Stock for issuance pursuant to outstanding options and warrants.

Common Stock

The holders of the Common Stock are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders. The Company's Certificate of Incorporation and By-Laws do not provide for cumulative voting rights in the election of directors. Accordingly, holders of a majority of the shares of Common Stock entitled to vote in any election of directors may elect all of the directors standing for election. Holders of Common Stock are entitled to receive ratably such dividends as may be declared by the Board of Directors out of funds legally available therefor. In the event of a liquidation, dissolution or winding up of the Company, holders of Common Stock are entitled to share ratably in the assets remaining after payment of liabilities. Holders of Common Stock have no preemptive, conversion or redemption rights. All of the outstanding shares of Common Stock are fully-paid and nonassessable.

Preferred Stock

The Board of Directors has the authority, without further stockholder

approval, to issue up to 6,000,000 shares of Preferred Stock from time to time in one or more series, to establish the number of shares to be included in each such series, and to fix the designations, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof. The issuance of Preferred Stock may have the effect of delaying or preventing a change in control of the Company. The issuance of Preferred Stock could decrease the amount of earnings and assets available for distribution to the holders of Common Stock, if any, or could adversely affect the rights and powers, including voting rights, of the holders of the Common Stock. In certain circumstances, such issuances could have the effect of decreasing the market price of the Common Stock.

Series C Preferred Stock

On May 15, 1998, the Board of Directors authorized the issuance of a series of Preferred Stock consisting of 375 shares (the "Series C Preferred Stock"), each such share of Series C Preferred Stock has a stated value of \$1,000 (the "Liquidation Preference"), pursuant to a Certificate of Designation (the "Certificate of Designation").

Dividends. The holders of the shares of Series C Preferred Stock are entitled to receive, when and as declared by the Board of Directors of the Company, dividends at the rate of five percent of the stated Liquidation Preference per share per annum, and no more, payable, at the discretion of the Board of Directors, in Common Stock or cash. Dividends accrue on each share of Series C Preferred Stock from the date of initial issuance. Such dividends are in preference to any distributions on any outstanding shares of Common Stock or any other equity securities of the Company that are junior to the Preferred Stock as to the payment of dividends.

Conversion Rights. The holders of Series C Preferred Stock shall have conversion rights as follows: (i) no shares of Series C Preferred Stock may be converted prior to August 15, 1998; (ii) at any time after August 15, 1998 through November 14, 1998, up to twenty-five (25%) percent of the shares of Series C Preferred Stock then outstanding may be converted, at the option of the holders thereof; and (iii) thereafter, on November 15, 1998, February 15, 1999 and May 15, 1999, an additional twenty-five (25%) percent of the shares of Series C Preferred Stock then outstanding may be converted, on a cumulative and pro rata basis, at the option of the

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holders thereof. The number of shares of fully-paid and nonassessable Common Stock into which each share of Series C Preferred Stock may be converted shall be determined by dividing the Liquidation Preference by an amount (the "Conversion Price") equal to the lesser of (A) 100% of the average closing bid price of the Common Stock as reported on the Nasdaq SmallCap Market or any successor exchange in which the Common Stock is listed for the five trading days preceding the date on which the holder of the Series C Preferred Stock has telecopied a notice of conversion to the Company (the "Conversion Date") and (B) \$4.00.

On May 15, 2000, the holders of the Series C Preferred Stock shall be required to convert all of their outstanding shares of Series C Preferred Stock into shares of Common Stock. Until converted, the Company shall be entitled to redeem shares of Series C Preferred Stock in accordance with the Certificate of Designation, regardless of whether or not a notice of conversion has been received by the Company with respect to such shares.

The Company shall at all times when any shares of Series C Preferred Stock shall be outstanding, reserve and keep available out of its authorized but unissued stock, such number of shares of Common Stock as shall from time to time be sufficient to effect the conversion of all outstanding shares of Series C Preferred Stock.

Redemption. At any time after May 15, 1998, the Company may, at the option of the Board of Directors, redeem up to 100% of the outstanding shares of the Series C Preferred Stock at the applicable redemption price, provided, that (x) the Company shall have received a notice of conversion, and (y) the Conversion Price is below \$3.40. The Company shall give written notice by telecopy, to the holder of Series C Preferred Stock to be redeemed at least one business day after receipt of the notice of conversion prior to the date specified for redemption (the "Redemption Date"). Such notice shall state the Redemption Date, the Redemption Price (as hereinafter defined), the number of shares of Series C Preferred Stock of such holders to be redeemed and shall call upon such holders to surrender to the Company on the Redemption Date at the place designated in the notice such holders' redeemed stock.

The Company shall have the option to redeem all or a portion of all the outstanding shares of Series C Preferred Stock at a cash price equal to \$3.40 multiplied by the number of shares the Series C Preferred Stock would convert

into on the date of redemption.

Voting Rights. Except as otherwise required by law, the holders of the Series C Preferred Stock shall not be entitled to vote upon any matter relating to the business or affairs of the Company or for any other purpose.

Status. In case any outstanding shares of Series C Preferred Stock shall be redeemed, the shares so redeemed shall be deemed to be permanently canceled and shall not resume the status of authorized but unissued shares of Series C Preferred Stock.

Other Designations of Preferred Stock

As of the date of this Prospectus, the Company has not designated any shares of Preferred Stock other than the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock. There are no other shares of Preferred Stock outstanding, and the Company currently has no plans to issue any other shares of Preferred Stock.

Transfer Agent and Registrar

The Company has appointed Continental Stock Transfer & Trust Company as Transfer Agent and Registrar for the Common Stock and the Redeemable Warrants.

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DELAWARE BUSINESS COMBINATION PROVISIONS

As a Delaware corporation, the Company is subject to Section 203 ("Section 203") of the Delaware General Corporation Law (the "DGCL"), which regulates large accumulations of shares, including those made by tender offers. Section 203 may have the effect of significantly delaying a purchaser's ability to acquire the entire interest in the Company if such acquisition is not approved by the Company's Board of Directors. In general, Section 203 prevents an "Interested Stockholder" (defined generally as a person with 15% or more of a corporation's outstanding voting stock) from engaging in a "Business Combination" (defined below) with a Delaware corporation for three years following the date such person became an Interested Stockholder. For purposes of Section 203, the term "Business Combination" is defined broadly to include mergers and certain other transactions with or caused by the Interested Stockholder, sales or other dispositions to the Interested Stockholder (except proportionately with the corporation's other stockholders) of assets of the corporation or a subsidiary equal to 10% or more of the aggregate market value of the corporation's consolidated assets or its outstanding stock; the issuance or transfer by the corporation or a subsidiary of stock of the corporation or such subsidiary to the Interested Stockholder (except for transfers in a conversion or exchange or a pro-rata distribution or certain other transactions, none of which increase the Interested Stockholder's proportionate ownership of any class or series of the corporation's or such subsidiary's stock); or receipt by the Interested Stockholder (except proportionately as a stockholder), directly or indirectly, of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation or a subsidiary.

The three-year moratorium imposed on Business Combinations by Section 203 does not apply if: (a) prior to the date on which a stockholder becomes an Interested Stockholder, the Company's Board of Directors approves either the Business Combination or the transaction that resulted in the person becoming an Interested Stockholder, (b) the Interested Stockholder owns 85% of the corporation's voting stock upon consummation of the transaction that made him or her an Interested Stockholder (excluding from the 85% calculation shares owned by directors who are also officers of the corporation and shares held by employee stock plans which do not permit employees to decide confidentially whether to accept a tender or exchange offer); or (c) on or after the date a person becomes an Interested Stockholder, the Company's Board of Directors approves the Business Combination, and it is also approved at a stockholder meeting by two-thirds of the voting stock not owned by the Interested Stockholder.

Under Section 203, the restrictions described above do not apply if, among other things, the corporation's original certificate of incorporation contains a provision electing not to be governed by Section 203. The Company's Certificate of Incorporation does not contain such a provision. The restrictions described above also do not apply to certain Business Combinations proposed by an Interested Stockholder following the announcement or notification of one of certain extraordinary transactions involving the corporation and a person who had not been an Interested Stockholder during the previous three years or who became an Interested Stockholder with the approval of a majority of the corporation's directors.

PLAN OF DISTRIBUTION

The shares of Common Stock being registered for offer by the Company will be issued directly to HSBC James Capel Canada, Inc. ("HSBC") in connection with the Financing Arrangement whereby the Company, at its option, may issue up to (a) \$31,200,000 of Common Stock to HSBC over a twelve-month period based on weekly, monthly or quarterly draw downs at a per share purchase price equal to the lesser of (i) 100% of the average of the daily volume weighted average price of the Common Stock on NASDAQ SmallCap Market for a certain number of consecutive trading days preceding the funding date of the draw down and (ii) \$8.00; provided, however, that if the purchase price of the Common Stock is less than \$3.00, HSBC will not be obligated to fund such weekly, monthly or quarterly draw down, (b) \$31,200,000 of Common Stock pursuant to the option granted by the Company to HSBC to purchase an additional amount of Common Stock equal to the maximum amount permitted to be drawn down for each draw down (the "Call Options") and (c) approximately 98,000 Shares, which Shares will be issued upon exercise of the Warrants which the Company will issue to the investor at each draw down. See "Financing Arrangement."

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The distribution of the Shares by the Selling Stockholder may be effected from time to time in one or more transactions (which may involve block transactions), in special offerings, exchange distributions and/or secondary distributions, in negotiated transactions, in settlement of short sales of Shares, or a combination or such methods of sale, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices. Such transactions may be effected on a stock exchange, on the over-the-counter market or privately. The Selling Stockholder may effect such transactions by selling the Shares to or through broker-dealers, and such broker-dealers may receive compensation in the form of underwriting discounts, concessions or commissions from the Selling Stockholder for whom they may act as agent (which compensation may be in excess of customary commissions). Without limiting the foregoing, such brokers may act as dealers by purchasing any and all of the Shares covered by this Prospectus either as agents for others or as principals for their own accounts and reselling such securities pursuant to this Prospectus. The Selling Stockholder and any broker-dealers or other persons acting on the behalf of parties that participate with such Selling Stockholder in the distribution of the Shares may be deemed to be underwriters and any commissions received or profit realized by them on the resale of the Shares may be deemed to be underwriting discounts and commissions under the Securities Act. As of the date of this Prospectus, the Company is not aware of any agreement, arrangement or understanding between any broker or dealer and the Selling Stockholders with respect to the offer or sale of the Shares pursuant to this Prospectus.

To the extent required under the Securities Act, a supplemental prospectus will be filed, disclosing (a) the name of any such broker-dealers, (b) the number of Shares involved, (c) the price at which such Shares are to be sold, (d) the commissions paid or discounts or concessions allowed to such broker-dealers, where applicable, (e) that such broker-dealers did not conduct any investigation to verify the information set out in this Prospectus, as supplemented, and (f) other facts material to the transaction.

The Company will not receive any proceeds from the sale of the Shares by the Selling Stockholder offered hereby. However, the Company expects to receive proceeds from the Financing Arrangement and to use such proceeds for general corporate purposes. The Company has agreed to pay all costs and expenses incurred in connection with the registration of the Common Stock offered hereby.

Pursuant to the Subscription Agreement, the Company and HSBC have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act, which may be based upon, among other things, any untrue statement or alleged untrue statement of a material fact made by the Company or HSBC, as the case may be, or any omission or alleged omission of a material fact with respect to the Company or HSBC, as the case may be. The Company shall bear customary expenses incident to the registration of the Shares for the benefit of HSBC in accordance with such agreements, other than underwriting discounts and commissions directly attributable to the sale of such securities by or on behalf of the HSBC.

The Company has agreed to keep the Registration Statement relating to the offering and sale of the Common Stock to HSBC continuously effective until the earlier of sale of all the Shares or 12 months.

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Section 145 of the DGCL provides, in general, that a corporation incorporated under the laws of the State of Delaware, such as the registrant, may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding (other than a derivative action by or in the right of the corporation) by reason of the fact that such person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe such person's conduct was unlawful. In the case of a derivative action, a Delaware corporation may indemnify any such person against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery of the State of Delaware or any other court in which such action was brought determines such person is fairly and reasonably entitled to indemnity for such expenses.

The Company's Certificate of Incorporation provides that directors shall not be personally liable for monetary damages to the Company or its stockholders for breach of fiduciary duty as a director, except for liability resulting from a breach of the director's duty of loyalty to the Company or its stockholders, intentional misconduct or wilful violation of law, actions or inactions not in good faith, an unlawful stock purchase or payment of a dividend under Delaware law, or transactions from which the director derives improper personal benefit. Such limitation of liability does not affect the availability of equitable remedies such as injunctive relief or rescission. The Company's Certificate of Incorporation also authorizes the Company to indemnify its officers, directors and other agents, by bylaws, agreements or otherwise, to the fullest extent permitted under Delaware law. The Company has entered into an Indemnification Agreement (the "Indemnification Agreement") with each of its directors and officers which may, in some cases, be broader than the specific indemnification provisions contained in the Company's Certificate of Incorporation or as otherwise permitted under Delaware law. Each Indemnification Agreement may require the Company, among other things, to indemnify such officers and directors against certain liabilities that may arise by reason of their status or service as a director or officer, against liabilities arising from willful misconduct of a culpable nature, and to obtain directors' and officers' liability insurance if available on reasonable terms.

The Company maintains a directors and officers liability policy with Genesis Insurance Company that contains a limit of liability of \$3,000,000 per policy year.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the small business issuer pursuant to the foregoing provisions, or otherwise, the small business issuer has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

LEGAL MATTERS

The validity of the securities offered hereby will be passed upon for the Company by Parker Chapin Flattau & Klimpl, LLP, New York, New York. Martin Eric Weisberg, Esq., a member of the firm, is a Director and the Secretary of the Company.

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EXPERTS

The consolidated balance sheets as of December 31, 1997 and 1996 and the related consolidated statements of operations, stockholders' equity and cash flows for the two years then ended included in this Prospectus have been so included in reliance on the report dated March 31, 1998, which includes an explanatory paragraph concerning the Company's ability to continue as a going concern, of PricewaterhouseCoopers LLP, independent accountants, given on their authority as experts in accounting and auditing.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
of Xybernaut Corporation and Subsidiary

We have audited the accompanying consolidated balance sheets of Xybernaut Corporation and Subsidiary (the Company) as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Xybernaut Corporation and Subsidiary as of December 31, 1997 and 1996, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company experienced a net loss of \$9,479,966 in 1997 and as discussed in Note 1 to the financial statements, is currently negotiating a commitment for an equity placement and a standby equity line. The Company's ability to draw upon this line of credit is contingent upon their ability to file and have the Securities and Exchange Commission declare effective a registration statement for these securities. In the event the Company can draw upon this standby equity line of credit, continuation of the business thereafter is dependent on the Company's ability to achieve a sufficient cash flow to meet its cash requirements. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plan in regard to these matters is also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

PricewaterhouseCoopers LLP

McLean, VA
March 31, 1998

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<TABLE>
<CAPTION>

XYBERNAUT CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS	December 31, 1997	December 31, 1996	June 30, 1998
	-----	-----	-----
			(unaudited)
<S>	<C>	<C>	<C>
Current assets:			
Cash and cash equivalents	\$ 952,366	\$ 6,274,967	\$ 4,014,723
Accounts receivable	216,767	427,790	182,363
Inventories	1,607,781	402,381	1,172,699
Prepaid and other current assets	334,245	197,711	399,883
	-----	-----	-----
Total current assets	3,111,159	7,302,849	5,769,668
	-----	-----	-----
Fixed assets:			
Property and equipment, net	505,695	323,828	773,788
	-----	-----	-----
Other assets:			
Patent costs, net	384,422	247,612	414,683
Tooling costs, net	376,990	106,738	312,368
Other	153,351	33,547	163,396
	-----	-----	-----
Total other assets	914,763	387,897	890,447
	-----	-----	-----
Total assets	\$ 4,531,617	\$ 8,014,574	\$ 7,433,903
	=====	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Notes and loans payable	\$ 19,530	\$ 7,849	\$-
Accounts payable	429,780	250,944	468,337
Deferred licensing revenue	-	60,000	-
Accrued expenses	908,372	571,742	809,068
	-----	-----	-----
Total current liabilities	1,357,682	890,535	1,277,405
	-----	-----	-----
Long-term liabilities:			
Notes and loans payable	-	44,080	-
Deferred licensing revenue	-	190,000	-
	-----	-----	-----
Total long-term liabilities	-	234,080	-
	-----	-----	-----
Total liabilities	1,357,682	1,124,615	1,277,405
	-----	-----	-----
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, \$.01 par value, 6,000,000, 5,000,000 and 6,000,000 (unaudited), shares authorized in 1997, 1996 and as of June 30, 1998 3,000 shares designated as Series A, for all periods 2,250 shares issued and outstanding as of December 31, 1997, no shares issued and outstanding 1996 or as of June 30, 1998 (unaudited) 3,180 shares designated as Series B for all periods, 3,180 shares issued and outstanding as of December 31, 1997, no shares issued and outstanding 1996 or as of June 30, 1998 (unaudited); 375 shares designated as Series C, 375 shares issued and outstanding as of June 30, 1998 no shares issued and outstanding; for 1997 or 1996	4,193,355	-	364,754
Common stock, \$.01 par value, 40,000,000, 30,000,000 and 40,000,000 (unaudited) shares authorized in 1997, 1996 and as of June 30, 1998, 14,360,515, 14,259,112 and 20,934,765 (unaudited) shares issued and outstanding as of December 31, 1997, 1996 and as of June 30, 1998	143,605	142,591	209,348
Additional paid-in capital	17,181,329	15,520,245	27,636,785
Deferred compensation	(91,511)	-	(9,042)
Accumulated deficit	(18,252,843)	(8,772,877)	(22,045,347)
	-----	-----	-----
Total stockholders' equity	3,173,935	6,889,959	6,156,498
	-----	-----	-----
Total liabilities and stockholders' equity	\$ 4,531,617	\$ 8,014,574	\$ 7,433,903
	=====	=====	=====

</TABLE>

The accompanying notes are an integral part of the consolidated financial

<TABLE>
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XYBERNAUT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		Six Months Ended June 30,	
	1997	1996	1998	1997
			(unaudited)	(unaudited)
<S>	<C>	<C>	<C>	<C>
Revenue:				
Product sales and leases	\$ 555,522	\$ 928,732	\$ 356,861	\$ 220,458
Consulting and license	257,000	164,609	1,839	30,000
Total revenue	812,522	1,093,341	358,700	250,458
Cost of sales	1,225,572	1,081,197	379,476	409,790
Gross profit (loss)	(413,050)	12,144	(20,776)	(159,332)
Operating expenses:				
Sales and marketing	3,280,356	1,442,146	1,151,147	1,489,195
General and administrative	3,518,868	2,158,212	1,617,879	1,885,214
Research and development	2,350,237	1,773,015	1,010,769	1,196,319
Total operating expenses	9,149,461	5,373,373	3,779,795	4,570,728
Operating loss	(9,562,511)	(5,361,229)	(3,800,571)	(4,730,060)
Interest income, net	82,545	122,693	8,067	49,129
Net loss	(9,479,966)	(5,238,536)	(3,792,504)	(4,680,931)
Provision for preferred stock dividends	82,905	-	2,344	-
Provision for accretion on preferred stock beneficial conversion feature	488,693	-	-	-
Net loss applicable to holders of common stock	\$ (10,051,564)	\$ (5,238,536)	\$ (3,794,848)	\$ (4,680,931)
Per common share (basic and diluted):				
Net loss before provisions for preferred stock	\$ (0.74)	\$ (0.47)	\$ (0.22)	\$ (0.38)
Total provisions for preferred stock	(0.04)	-	-	-
Net loss applicable to holders of common stock	\$ (0.78)	\$ (0.47)	\$ (0.22)	\$ (0.38)
Weighted average number of common shares outstanding (basic and diluted)	12,844,974	11,121,594	17,016,067	12,459,112

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
<CAPTION>

XYBERNAUT CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Total Value of Shares

	Total Number of Shares		-		Additional	Accumulated	Deferred	Total
	Common	Preferred	Common	Preferred	Paid-in Capital	Deficit	Compensation	Stockholder's Equity
<S>								
<C>								
Balance, December 31, 1995.....	10,372,489	--	\$ 103,725	--	\$ 2,337,663	\$(3,534,341)	--	\$(1,092,953)
Shares issued pursuant to IPO.....	2,415,000	--	24,150	--	10,818,337	--	--	10,842,487
Shares issued pursuant to conversion debentures.....	of 1,431,427	--	14,314	--	2,290,244	--	--	2,304,558
Shares issued pursuant to redemption warrants.....	of 20,000	--	200	--	34,800	--	--	35,000
Shares issued for services and incentives	20,496	--	205	--	89,201	--	--	89,406
Acquisition of Tech Virginia.....	(300)	--	(3)	--	(50,000)	--	--	(50,003)
Net loss.....	--	--	--	--	--	(5,238,536)	--	(5,238,536)
Balance, December 31, 1996.....	14,259,112	--	142,591	--	15,520,245	(8,772,877)	--	6,889,959
Issuance of Series A Preferred Stock	--	3,000	--	\$2,761,669	--	--	--	2,761,669
Partial conversion of Series A Stock Common Stock.....	into 250,000	(750)	2,500	(690,417)	687,917	--	--	--
Cancellation of escrow shares of Common Stock.....	(300,000)	--	(3,000)	--	3,000	--	--	--
Cancellation of accrued shares of Common Stock.....	(1,747)	--	(17)	--	17	--	--	--
Issuance of Series B Preferred Stock	--	3,180	--	2,948,737	--	--	--	2,948,737
Exercise of stock options.....	150,000	--	1,500	--	--	--	--	1,500
Value of beneficial conversion featur on Series A and B Preferred Stock e	--	--	--	1,219,712	(1,219,712)	--	--	--
Accretion of deemed dividend of Preferred Stock.....	--	--	--	488,693	(488,693)	--	--	--
Preferred stock dividend requirements	--	--	--	--	(82,905)	--	--	(82,905)
Issuance of warrants on Common Stock	--	--	--	--	217,000	--	\$ (217,000)	--
Compensation related to Common Stock warrants.....	--	--	--	--	--	--	125,489	125,489
Warrants issued in connection with Preferred Stock offerings.....	--	--	--	(95,615)	95,615	--	--	--
Dividends on preferred stock paid with Common Stock.....	--	31	--	9,421	--	--	9,452	--
Net loss.....	--	--	--	--	--	(9,479,966)	--	(9,479,966)
Balance, December 31, 1997.....	14,360,515	5,430	143,605	4,193,355	17,181,329	(18,252,843)	(91,511)	3,173,935
Issuance of Series B Preferred Stock (unaudited).....	--	1,000	--	875,299	--	--	--	875,299
Issuance of Series C Preferred Stock (unaudited).....	--	375	--	364,754	--	--	--	364,754
Partial conversion of Series A Prefer Stock into Common Stock				1,887,277				
(unaudited).....	rel 1,652,649	(2,250)	16,527	()	1,870,750	--	--	--
Partial conversion of Series B Preferre Stock into Common Stock (unaudited)	3,128,045	(4,180)	31,280	()	3,524,322	--	--	--
Sales of Common Stock (unaudited)..	1,649,718	--	16,498	--	5,265,556	--	--	5,282,054
Issuance of accrued Common Stock (unaudited).....	50,000	--	500	--	97,938	--	--	98,438
Accretion of deemed dividend of Preferred Stock (unaudited).....	--	--	--	374,225	(374,225)	--	--	--
Preferred Stock dividend requirements (unaudited).....	--	--	--	--	(52,220)	--	--	(52,220)
Compensation related to Common Stock warrants (unaudited).....	--	--	--	--	--	--	82,469	82,469
Dividends on preferred stock paid with Common Stock (unaudited)...	96,988	--	970	--	126,453	--	--	127,423
Cancellation of accrued shares of Common Stock (unaudited).....	(3,150)	--	(32)	--	(3,118)	--	--	(3,150)
Net loss (unaudited).....	--	--	--	--	--	(3,792,504)	--	(3,792,504)
Balance, June 30, 1998 (unaudited).	20,934,765	375	\$209,348	\$364,754	\$27,636,785	\$(22,045,347)	\$(9,042)	\$6,156,498

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
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XYBERNAUT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOW

	Year Ended December 31,		Six Months Ended June 30,	
	1997	1996	1998	1997
Cash flows from operating activities:			(unaudited)	(unaudited)
<S>	<C>	<C>	<C>	<C>
Net loss	\$ (9,479,966)	\$ (5,238,536)	\$ (3,792,504)	\$ (4,680,931)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	277,299	264,699	152,185	160,547
Provision for write-down of inventory	724,978	202,440	-	-
Provision for bad debts	253,211	-	(30,697)	-
Non cash charges for tooling costs	-	-	138,682	-
Non cash charges for stock and options issued for services	125,489	89,406	82,469	125,488
Changes in assets and liabilities:				
Inventories	(1,930,378)	(354,871)	109,730	(295,792)
Accounts receivable	(42,188)	(337,065)	65,101	(2,338)
Prepaid and other current assets	(136,534)	(177,094)	(65,638)	(184,312)
Other assets	(119,804)	(10,540)	(10,528)	(4,798)
Accounts payable and accrued expenses	515,466	177,619	(14,873)	(74,373)
Deferred licensing revenue	(250,000)	250,000	-	(30,000)
Net cash used in operating activities	(10,062,427)	(5,133,942)	(3,366,073)	(4,986,509)
Cash flows from investing activities:				
Acquisition of property and equipment	(364,678)	(315,257)	(33,515)	(306,962)
Acquisition of patents and related costs	(231,298)	(114,618)	(91,190)	(155,888)
Capitalization of tooling costs and other assets	(270,252)	(106,738)	(74,060)	(284,294)
Net cash used in investing activities	(866,228)	(536,613)	(198,765)	(747,144)
Cash flows from financing activities:				
Proceeds from:				
Preferred stock offerings, net	5,710,406	-	1,348,496	2,785,000
Common stock offerings, net	-	-	5,307,048	-
Debentures	-	1,000,000	-	-
Notes and loans	56,500	340,000	-	-
Initial public offering	-	13,282,500	-	215,000
Payments for:				
Notes and loans	(72,232)	(591,161)	(19,530)	(48,924)
Acquisition of Tech Virginia	(16,667)	(33,334)	-	-
Initial public offering and debenture fees	-	(2,561,149)	-	-
Other	(71,953)	-	(8,819)	-
Net cash provided by financing activities	5,606,054	11,436,856	6,627,195	2,951,076
Net increase (decrease) in cash and cash equivalents	(5,322,601)	5,766,301	3,062,357	(2,782,577)
Cash and cash equivalents, beginning of period	6,274,967	508,666	952,366	6,274,967
Cash and cash equivalents, end of period	\$ 952,366	\$ 6,274,967	\$ 4,014,723	\$ 3,492,390
Supplemental disclosure of cash information:				
Cash paid during the period for interest	\$ 7,124	\$ 71,750	\$ 2,500	\$ 8,527
Supplemental disclosure of non-cash financing activities:				
Common stock issued for preferred stock dividend requirements	\$ 9,421	\$ -	\$ 126,453	\$ -
Common stock issued for services rendered	\$ -	\$ 89,406	\$ 98,438	\$ -
Deferred compensation in connection with stock warrants granted	\$ 217,000	\$ -	\$ -	\$ -
Issuance of warrants in connection with preferred stock offering	95,615	\$ -	\$ -	\$ -

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

XYBERNAUT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business and Financing:

The Company:

Xybernaut Corporation (the "Company") was originally incorporated in Virginia in October 1990 as Contemporary Products & Services, Inc. and changed its name to Computer Products & Services, Inc. ("CPSI") in 1992. In April 1996, the Company was merged with Xybernaut Corporation to change the Company name and reincorporate in Delaware. Since the commencement of operations in November 1992, the Company has engaged in the research, development and commercialization of products intended to bridge the widening gap between people and knowledge. The first product to be commercialized by the Company is the proprietary portable computer technology and related software applications embodied in its Mobile Assistant(R) product. Additional software products are planned for development and use on the Mobile Assistant(R) and other personal computers.

On July 18, 1996, the Company successfully completed the Initial Public Offering ("IPO") of its Common Stock and warrants (NASDAQ symbol XYBR and XYBRW) which are traded on the NASDAQ SmallCap Market.

The Company was a development stage enterprise through March 31, 1995. Subsequently, the Company has commenced principal operations and, accordingly, these financial statements are not presented in compliance with Statement of Financial Accounting Standard No. 7 which describes the financial presentation for development stage enterprises.

Financing:

The Company has received a commitment for an equity placement of \$1 million and a standby equity line of \$10 million and is in the process of finalizing these arrangements. The Company's ability to draw upon this line of credit is contingent upon its ability to file and have the Securities and Exchange Commission declare effective a registration statement for these securities. In the event the Company can draw upon this standby equity line of credit, continuation of the business thereafter is dependent on the Company's ability to achieve a sufficient cash flow to meet its cash requirements. This commitment expires on April 14, 1998. It is the opinion of the Company's management that such funding arrangements are readily available to the Company and the execution of any such arrangements is a decision that will depend on timing, market conditions and the final terms and conditions of such arrangements. Production of the MA IV model of the Mobile Assistant(R) is expected to begin in the quarter ending December 31, 1998, and receivables from sales of the Mobile Assistant(R) are expected to provide significant collateral for borrowing facilities at that point. Although there can be no assurance that such facilities will be available, the Company intends to seek to establish secured borrowing facilities as soon as appropriate collateral is available. The Company's management believes that the combination of cash on hand, operating cash flows, and additional outside funding will provide sufficient liquidity to meet the Company's cash requirements until at least March 1999.

2. Summary of Significant Accounting Policies

Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Tech International of Virginia Inc. ("TechVirginia"). In connection with the IPO, the Company

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exercised its option to acquire all of the capital stock of Tech Virginia. Financial statements prior to the exercise of the option reflect the combined financial position and results of operations of the Company and Tech Virginia. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates in the Preparation of Financial Statements:

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.

Cash and Cash Equivalents:

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Inventories:

Inventories, consisting principally of component parts held for resale, are stated at the lower of cost or market, with cost determined by the first-in, first-out method. As of December 31, 1997 and 1996, the allowance to reduce inventory balances to net realizable value was \$724,978 and \$202,440, respectively. Most of the reserves and write downs in inventory values result from the introduction of new products and technology resulting in a reduction or loss of value of older products or technology. The sales prices of the 133P model of the Mobile Assistant(R) will be monitored in light of the introduction of the MA IV model and reserves will be taken as appropriate if the value of the 133P inventory is determined to have been impaired. At this point, the Company's management does not believe that the value of the 133P model has been significantly impaired by the introduction of the MA IV.

Property, Equipment, Furniture and Fixtures:

Property, equipment, furniture and fixtures are stated at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets, as follows:

Equipment.....	3-5 years
Furniture and fixtures.....	5 years
Demonstrator units.....	2 years
Leasehold improvements.....	3 years

Expenditures for maintenance and repairs are charged directly to the appropriate operating account at the time the expense is incurred. Expenditures determined to represent additions and betterments are capitalized.

Software Development Costs:

The Company's policy is to capitalize software development costs when technological feasibility has been established, based on a detailed program design that is complete, has been confirmed and for which no high-risk development issues remain.

The establishment of technological feasibility and the ongoing assessment of the recovery of capitalized software costs requires considerable judgment by management with respect to certain external factors including, but not limited to, technological feasibility, anticipated future gross revenues, estimated economic life and changes in software and hardware technologies. Capitalization of software costs will cease when the software is available for general release to customers, at which time amortization of the costs begins. These costs will be amortized using the greater of the amount computed using the straight-line method over the remaining estimated economic life of the product or the ratio of current gross revenues from the product to the total of current and anticipated future gross revenues from the product. Since the Company is currently in the planning and development phase for software toolkits, no costs have been capitalized to date.

Intangible Assets:

Patent costs consist of legal fees, filing fees and other direct costs incurred in obtaining and maintaining patents and are amortized on a straight-line basis over a five-year period.

Tooling Costs:

Tooling costs consist of reimbursed expenses to third-party vendors for molds to be used exclusively in the manufacturing of the Company's proprietary head-mounted display ("HMD") and the computing unit for the Mobile Assistant (R). Capitalized tooling costs will be transferred to inventory based on the estimated total number of HMDs and computing units to be produced from the molds. No costs have been transferred to inventory as of December 31, 1997.

Impairment of Long-Lived Assets:

Management of the Company monitors the carrying value of long-lived assets for potential impairment on an on-going basis. Potential impairment would be determined by comparing the carrying value of these assets with their related, expected future net cash flows. Should the sum of the related, expected future net cash flows be less than the carrying value, management would

determine whether an impairment loss should be recognized. An impairment loss would be measured by the amount by which the carrying value of the asset exceeds the future discounted cash flows.

Revenue Recognition and Warranties:

Product sales are recorded on shipment pursuant to a valid customer purchase order. For equipment shipped under equipment rental or leasing agreements, revenue is recognized on a straight-line basis over the term of the rental or lease agreement. Consulting revenue is recognized as the services are performed pursuant to a written agreement with the client. The Company generally provides a one-year warranty on parts. The Company's suppliers for the computing unit and the HMD provide the Company with similar warranties and as a result warranty reserves are immaterial.

Research and Development Programs:

Research and development costs are charged to operations as incurred, including the cost of components purchased for testing and product development that are salable but are intended for development work only.

Income Taxes:

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and income tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Income tax expense is the

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tax payable or refundable for the period plus or minus the change during the period in deferred income tax assets and liabilities.

Net Loss Per Share:

Effective December 31, 1997, the Company adopted SFAS No. 128, "Earnings Per Share," which requires the presentation of basic earnings per share and diluted earnings per share. Basic earnings per share are based on the weighted average number of outstanding shares of Common Stock. Diluted earnings per share adjusts the weighted average for the potential dilution that could occur if stock options, warrants or other convertible securities were exercised or converted into Common Stock. For all periods presented herein and for historical quarterly earnings per share amounts, diluted earnings per share is the same as basic earnings per share for the Company because the effects of such items were anti-dilutive given the losses incurred in such periods. Earnings per share for all periods presented conform to SFAS No. 128.

Escrowed Shares:

Escrowed shares, if any, are considered issued and outstanding and reported as such on the balance sheet. For purposes of computing the net loss per common and common equivalent share, they are not considered outstanding until the conditions for their release are met.

Fair Value of Financial Instruments:

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable and accounts payable approximated fair value as of December 31, 1997 and 1996, because of the relatively short maturity of these instruments. The carrying value of the notes and loans payable approximated fair value as of December 31, 1997 and 1996, based upon market prices for the same or similar debt issues.

Recent Accounting Pronouncements:

The Financial Accounting Standards Board has issued two new standards which become effective for reporting periods beginning after December 15, 1997. SFAS No. 130, "Reporting Comprehensive Income," requires additional disclosures with respect to certain changes in assets and liabilities that previously were not required to be reported as results of operations for the period. The Company will begin making the additional disclosures required by SFAS No. 130 in the first quarter of 1998. SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," requires financial and descriptive information with respect to "operating segments" of an entity based on the way management desegregates the entity for making internal operating decisions. The Company will begin making the disclosures required by SFAS No. 131 with financial statements for the period ending December 31, 1998.

Interim results (unaudited):

The accompanying consolidated balance sheet at June 30, 1998, the consolidated statements of operations and cash flows for the six months ended June 30, 1998 and 1997 and the consolidated statement of stockholders' equity for the six months ended June 30, 1998 are unaudited. In the opinion of management, these statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments necessary for the fair presentation of the results for the interim periods. The data disclosed in the Notes to Consolidated Financial Statements for these periods are unaudited. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period.

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3. Property and Equipment:

Property and equipment consists of the following:

	December, 31,	
	1997	1996
Equipment.....	\$ 537,635	\$ 227,068
Furniture and fixtures.....	74,207	44,814
Demonstrator units.....	53,144	53,144
Leasehold improvements.....	149,659	124,941
	814,645	449,967
Less accumulated depreciation.....	(308,950)	(126,139)
	\$ 505,695	\$ 323,828

Depreciation expense for the years ended December 31, 1997 and 1996 was \$186,761 and \$80,231, respectively.

4. Debt:

Effective November 17, 1995, the Company sold \$1,505,000 principal amount of 7% Convertible Debentures due in 1997 (the "November 1995 Debentures") and paid a placement fee of 10% to the placement agent in the form of an interest-bearing promissory note due at the time of the IPO. On April 16, 1996, the Company sold \$1,000,000 principal amount of 7% Convertible Debentures due in 1997 (the "April 1996 Debentures") and paid a placement fee of 12% to the placement agent in the form of an interest-bearing promissory note due at the time of the IPO.

Under the terms of these debentures, the Company had the right to redeem all debentures, at a price equal to 105% of principal, plus accrued interest, if the IPO had not occurred within one year after the closing date. The November 1995 Debentures and the April 1996 Debentures were to convert into Units upon a successful IPO by the Company at the rate of one Unit for each \$1.75 in principal. The November 1995 Debentures and the April 1996 Debentures were converted into 1,431,427 Units on July 18, 1996, concurrent with the Company's IPO.

5. Stockholders' Equity:

Initial Public Offering

On July 18, 1996, the Company completed its IPO and sold 2,415,000 Units at a price of \$5.50 per Unit. Each Unit consisted of one share of Common Stock and one warrant to purchase a share of Common Stock at \$9.00 ("Unit"). Gross proceeds from the sale of the Units were \$13,282,500 and net proceeds after expenses were \$10,842,487.

At the completion of the offering, the underwriter received an option to purchase 210,000 Units at a price equal to 165% of the unit offering price per unit during a period of four years commencing one year from July 18, 1996.

In connection with this offering, the Company's officers and directors and certain stockholders deposited an aggregate of 1,800,000 shares of Common Stock of the Company in an escrow account ("Escrowed Shares"). The Common Stock in the escrow account is subject to release to such stockholders in increments over a three year period only in the event the Company's gross revenues and earnings (loss) per share for the twelve month periods ending September 30, 1997, 1998 and 1999 meet or exceed certain performance targets. If the performance targets are not met in any of the twelve month periods ending September 30, 1997, 1998, or 1999, the Escrowed Shares will be returned to the

Company. In addition to the foregoing, all Escrowed Shares will be

released to the stockholders if certain stock price targets are met. The market value of any Escrowed Shares held by officers, employees or consultants at the time they are released will be deemed to be additional compensation expense to the Company. The parameters for the September 30, 1997 release were not met and 300,000 shares were canceled from the Escrowed Shares.

Common Stock (unaudited)

In April 1998, the Company entered into an equity line of credit agreement in which the Company received an initial gross amount of \$1,000,000 in exchange for 840,124 shares of Common Stock. Under this line of equity the Company has the right, but not the obligation, to obtain up to an additional \$10,000,000 in a series of equity draw downs based on terms and conditions specified in the line of equity. In connection with this line of equity, the Company issued warrants to purchase up to 40,000 shares of stock at \$1.76 and 20,000 shares of stock at \$2.81 at any time starting six months after closing and ending five years after closing. The placement agent for this transaction received a cash fee of 5% and 50,000 shares of unregistered stock.

In May 1998, the Company completed a \$375,000 private placement in which the Company issued 110,294 shares of Common Stock

In June 1998, the Company completed a \$1,000,000 private placement in which the Company issued 153,846 unregistered shares of Common Stock.

In June 1998, the Company amended and exercised a put option in the aggregate principal amount of \$3,000,000 under the private line of equity agreement mentioned above. In connection with such action, the Company issued 545,454 shares of Common Stock.

Preferred Stock (unaudited)

In January 1998, the Company placed 1,000 shares of Series B Preferred Stock and received cash proceeds of approximately \$974,000 from this issuance. In connection with this placement and the placement of 3,000 shares of Series B Preferred Stock in November 1997, the placement agent received 50,000 shares of Common Stock in lieu of 60 shares of Series B Preferred, warrants to purchase 25,000 shares of Common Stock at \$2.1313 and warrants to purchase 75,000 shares of Common Stock at \$3.025. During the six months ended June 30, 1998, 2,250 shares of Series A Preferred Stock and 4,180 shares of Series B Preferred Stock were converted to 4,878,074 shares of Common Stock, pursuant to their respective terms. As of the current date, all of the 3,000 shares of Series A Preferred Stock and 4,180 shares of Series B Preferred Stock issued by the Company have been fully converted resulting in the issuance of 1,958,984 and 3,172,239 shares of Common Stock, respectively.

In May 1998, the Company placed 375 shares of Series C Preferred Stock and received cash proceeds of \$375,000 from this issuance. No shares of Series C Preferred Stock have been converted as of the date hereof.

The Company's outstanding common stock and preferred stock are summarized below:

<TABLE>
<CAPTION>

	Par Value Per Share	Dec. 31, 1997				Number of Shares Issued and Outstanding	
		Number of Shares Authorized	December 31, 1997	December 31, 1996	December 31, 1997	December 31, 1996	June 30, 1998
							(unaudited)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	
Common Stock.....	\$0.01	40,000,000	14,360,515	14,259,112	20,934,765	-	
Preferred Stock.....	\$0.01	6,000,000					
Series A Preferred stock.....	\$0.01		2,250	-	-	-	
Series B Preferred stock.....	\$0.01		3,180	-	-	-	
Series C Preferred stock.....	\$0.01		-	-	-	375	

</TABLE>

Under the terms of the Company's Articles of Incorporation, the Board of Directors may determine the rights, preferences, and terms of the Company's authorized but unissued shares of preferred stock. During the year ended December 31, 1996, the Company issued 100,000 warrants of Common Stock in exchange for services provided by an independent contractor, for which compensation expense of \$125,489 was recorded for the year ended December 31, 1997. On June 30, 1997 and November 12, 1997, the Company granted to the underwriters of the Series A Preferred Stock and Series B Preferred Stock warrants to purchase a total of 97,860 shares of Common Stock at prices that range from \$3.44 to \$4.50 per share. For the year ended December 31, 1997, the Company recorded approximately \$96,000 as a reduction of proceeds from these preferred stock offerings.

Outstanding Warrants:

At December 31, 1997, outstanding warrants pursuant to the IPO were 2,415,000 and outstanding warrants pursuant to the conversion of the November 1996 Debentures and the April 1997 Debentures were 1,431,427. These 3,846,427 warrants originally entitle the holder to purchase one share of the Company's Common Stock at an exercise price of \$9.00 and expire on July 17, 1999. These warrants contain anti-dilution provisions that, upon issuance of the Series A Preferred Stock and the Series B Preferred Stock, have adjusted the number of shares that can be purchased with one warrant to \$1.19, resulting in an effective exercise price of \$7.55, and 4,583,402 shares that would be issued upon full conversion of the warrants.

6. Stock Options:

On April 18, 1996, the Board of Directors approved, effective January 1, 1996, the Company's 1996 Omnibus Stock Incentive Plan (the "Plan"). Under the Plan, the Company has reserved 650,000 shares of Common Stock for issuance of both incentive and non-qualified options, restricted stock awards and stock appreciation rights ("SARs"). The Plan is administered by the Compensation Committee of the Board of Directors. At the annual meeting of stockholders on August 28, 1997, Company stockholders approved the 1997 Stock Incentive Plan, which provides for up to 1,650,000 shares of the Company's stock. Under these plans, Options generally become exercisable, beginning one year after the date granted, in five equal annual installments. No option may be granted at a priceless than the stock's fair market value on the date of the grant.

Prior to the approved Plan, the Company's Board of Directors approved 250,000 of non-Plan stock options which become exercisable, beginning one year after the date granted, in five equal annual installments.

Information on options is as follows:

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<TABLE>

<CAPTION>

	Shares Under Option	Range of Exercise Prices	Weighted Average Strike Price
<S>	<C>	<C>	<C>
Outstanding at December 31, 1995.....	555,530	\$ 0.01-6.00	\$2.62
Granted.....	542,000	\$2.00-12.00	\$3.25
Exercised.....	-	-	-
Canceled.....	(103,600)	\$ 6.00	\$6.00

Outstanding at December 31, 1996.....	993,930	\$0.01-12.00	\$2.97
Granted.....	1,033,300	\$ 1.37-6.00	\$3.13
Exercised.....	(150,000)	\$ 0.01	\$0.01
Canceled.....	(249,800)	\$ 2.25-6.00	\$4.85

Outstanding at December 31, 1997.....	1,627,430	\$ 0.01-6.00	\$3.04
=====			
Exercisable at December 31, 1997.....	271,906	\$ 2.25-6.00	\$3.55
=====			

</TABLE>

At December 31, 1997, weighted average remaining contractual life for options outstanding was 3.69 years. The fair value of the options granted during the years ended December 31, 1997 and 1996 was \$1,246,600 and \$1,504,643, respectively.

During the six months ended June 30, 1998, the Company canceled 575,380 (unaudited) stock options with exercise prices ranging from \$0.01 (unaudited) to

\$6.00 (unaudited) per share.

In October 1996, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") effective for fiscal years beginning after December 15, 1996. SFAS No. 123 established financial accounting and reporting standards for stock-based compensation plans. The Company has adopted the disclosure-only provisions of SFAS No. 123. In accordance with the provisions of SFAS No. 123, the Company applies APB Opinion 25 and related interpretations in accounting for its Plan and, accordingly, does not recognize compensation expense.

Had compensation expense for the Company's plan been determined based on the fair value at the grant date for awards in 1997 and 1996 consistent with the provisions of SFAS No. 123, the Company's net loss and net loss per common and common equivalent shares outstanding would have been the pro forma amounts indicated below:

	Year Ended December, 31 1997	Year Ended December 31, 1996
Net loss - as reported.....	\$ (9,479,966)	\$ (5,238,536)
Net loss - pro forma.....	\$ (10,170,223)	\$ (5,508,736)
Net loss per share - as reported.....	\$ (0.74)	\$ (0.47)
Net loss per share - pro forma.....	\$ (0.79)	\$ (0.50)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 1997 and 1996: dividend yield of 0%; expected volatility of 60%; risk-free interest rate of 6.41% in 1997 and 5.92% in 1996; and expected lives of 3 years.

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7. Significant Customers:

The percentages of total revenue from sales to customers in excess of 10% of the total for each period were as follows:

<TABLE>
<CAPTION>

	Year Ended December 31, 1997	Year Ended December 31, 1996	Six Months Ended June 30, 1998
			(unaudited)
<S>	<C>	<C>	<C>
Customer A.....	34%	64%	--
Customer B.....	-	24%	--
Customer C.....	10%	-	--

</TABLE>

8. Licensing Agreement:

In March 1996, the Company entered into a non-exclusive five-year licensing agreement with Rockwell International. Pursuant to this agreement, the Company was granted a price reduction of \$1,395,000 related to a purchase order issued in 1996 and received an initial cash payment of \$300,000 that was recorded as deferred licensing revenue and is being recognized as revenue on a straight-line basis over the five year term. Revenue of \$50,000 related to this licensing agreement was recognized for the year ended December 31, 1996. During the year ended December 31, 1997, the Company's licensee informed the Company that as a result of the restructuring of its business operations, the licensee had elected to not continue with its business activities under the license. A portion of the consideration received by the Company in March 1996 for granting this license was a \$300,000 cash payment, which the Company recorded as deferred license revenue and was amortizing this amount over a five year period. Given the licensee's stated intent to not to continue conducting business operations under the license, the remaining deferred licensing revenue of \$250,000 as of December 31, 1996, was recorded as revenue in the year ended December 31, 1997.

9. Income Taxes:

For the year ended December 31, 1997 no income tax benefit has been

provided because the losses could not be carried back and realization of the benefit of the net operating losses carried forward was not assured. At December 31, 1997, the Company has approximately \$16,026,000 of net operating loss carry forwards for federal income tax purposes. These losses expire in 2012. The use of these carry forwards may be limited in any one year under Internal Revenue Code Section 382 if significant ownership changes occurring the future. Net deferred tax assets are comprised of the following:

	December, 31 1997	December 31, 1996
	-----	-----
Excess of book over tax depreciation.....\$	23,000	\$ 30,000
Net operating loss carryforwards.....	6,084,000	2,758,000
Adjustment to accrual basis of accounting....	283,000	56,000
Accrued vacation.....	-	11,000
Deferred revenue.....	-	95,000
Tax credit carryforwards.....	63,000	63,000
Less valuation allowance.....	(6,453,000)	(3,013,000)
	-----	-----
Net deferred tax asset.....	-	-
	=====	=====

10. Commitments and Contingencies:

Lease Commitments:

During 1994 and 1996, the Company began leasing its operating facilities and certain equipment under various operating leases expiring on various dates through 2001. Future minimum payments under noncancelable operating leases at December 31, 1997 are:

Year Ending December 31,

1998.....	\$ 289,614
1999.....	38,891
2000.....	21,202
2001.....	2,721
2002.....	-

Total rental expense charged to operations for the year ended December 31, 1997 and December 31, 1996 was \$258,071 and \$202,812, respectively.

Purchase Agreements

The Company has agreements with certain suppliers to purchase specialized parts and components necessary to produce the Mobile Assistant(R). Failure of any of these parties to comply with the terms and conditions of existing agreements could adversely affect the Company's ability to complete and deliver Mobile Assistant(R) units. The Company is engaged in discussions with the supplier of the computing unit for its 133P model of the Mobile Assistant(R) regarding direct assumption by the Company of certain components for the 133P currently held by this supplier. While the outcome of these discussions is not certain, if the Company were to assume ownership of the maximum amounts of these components, approximately \$600,000 would be added to inventory and accounts payable would increase by the same amount.

Patents

The Company considers its patents, trade secrets, and other intellectual property and other proprietary information to be an important factor in its business prospects. In September 1995, the Company received a notification from the United States Patent and Trademark Office ("PTO") entitled "office action in re-examination" which indicated that the Company's claims under its existing patent for the Mobile Assistant(R) were subject to re-examination and had been preliminary rejected. During 1996, this preliminary rejection was over turned. In April 1997 a second re-examination request was filed with the PTO and the Company received a notification from the United States Patent and Trademark Office ("PTO") entitled "office action in re-examination" which indicated that the Company's claims under its existing patent for the Mobile Assistant(R) were subject to re-examination and had been preliminary rejected. During 1997, this preliminary rejection was overturned. In October 1996, the Company filed a patent application covering additional embodiments and extensions of the technologies used in the Mobile Assistant(R). In addition, eight additional patent applications have been filed with the PTO since the Company's IPO.

Commitments (unaudited)

The Company entered into a Memorandum of Understanding ("MOU") with Sony Digital Products ("SODP") on May 14, 1998. This agreement obligates the Company to reimburse SODP Yen 100 million over a ten month period commencing April 1998. These payments are reimbursements to SODP for engineering and development of the Company's Mobile Assistant IV(TM). The Company, through June

Yen 15 million under the Memorandum of Understanding in accordance with the payment terms. The balance of the payments and the related recognition of expense will occur as the services are provided by SODP to the Company.

11. Legal Proceedings:

On March 19, 1998, Matrix Corporation (see "Key Suppliers") filed a summons against the Company in the United States District Court, Eastern District of North Carolina, alleging that: Matrix has been damaged by a purported breach of the December Agreement by the Company; that the Company should return all goods shipped by Matrix under both the June Agreement and the December Agreement; that the Company did not intend to comply with the December Agreement and therefore the governing contract between the two entities should revert to the June Agreement. In addition, this summons requests that any damages incurred by Matrix as a result of this purported breach of contract be trebled. The Company and its legal counsel have initiated a thorough review of these allegations and intend to file a counterclaim against Matrix stating that Matrix failed to perform to the requirements of both the June Agreement and the December Agreement and that Xybernaut has been damaged by this failure to perform. While there can be no assurance of the outcome of this legal proceeding, the Company's management believes that the claims by Matrix are groundless and that the impact of this legal proceeding will not be adversely material to the Company's operations. The maximum amount payable by the Company under the December Agreement if Matrix performs defined tasks is approximately \$250,000 and the maximum amount of inventory that could be assumed by the Company under the December Agreement is approximately \$600,000.

12. Related Party Transactions:

The Company uses a director of the Company as its patent counsel and paid cash to this director for fees and reimbursement of expenses of approximately \$276,000 in 1997 and for reimbursement of expenses of \$93,250 in 1996. An individual who was a director of the Company through August 1997 was paid \$20,750 during 1997 for consulting services pursuant to a contract between that director and the Company. A director of the Company serves as a consultant to the Company and during 1997 was paid \$305,000 in consulting payments for the years 1996 and 1997 and \$111,000 as reimbursement for expenses incurred during those two years. The Company accrued, but did not pay in cash, \$97,800 in salaries and automobile allowances payable to a director of the Company for services provided to Tech Virginia. The Company paid \$172,000 as advances on commissions and expenses to an individual consultant who is an uncle by marriage to the President of the Company. During 1997, the Company paid approximately \$81,000 for sales and marketing consulting fees and expenses to two members of the SBS software center in Germany and the Company sold approximately \$135,000 of products to the SBS software center during this period.

13. Concentration of Credit Risk Arising from Cash Deposits:

The Company's December 31, 1997 cash and cash equivalent balance includes approximately \$1.0 million of cash invested in a pool of United States Government and Agency Securities. The amount in excess of insurance provided by the Federal Deposit Insurance Company is approximately \$900,000.

No dealer, salesman or any other person has been authorized to give any information or to make any representations, other than those contained in this Prospectus, and, if given or made, such information or representations must not be relied upon as having been authorized by the Company or by the Underwriter. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any securities offered hereby by anyone in any jurisdiction in which such offer or solicitation is not qualified and to do so or to anyone to whom it is unlawful to make such offer or solicitation.

_____ Shares
XYBERNAUT CORPORATION

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PART II.
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 24. Indemnification of Directors and Officers

Section 145 of the General Corporation Law of the State of Delaware (the "DGCL") provides, in general, that a corporation incorporated under the laws of the State of Delaware, such as the registrant, may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding (other than a derivative action by or in the right of the corporation) by reason of the fact that such person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe such person's conduct was unlawful. In the case of a derivative action, a Delaware corporation may indemnify any such person against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery of the State of Delaware or any other court in which such action was brought determines such person is fairly and reasonably entitled to indemnity for such expenses.

The Company's Certificate of Incorporation provides that directors shall not be personally liable for monetary damages to the Company or its stockholders for breach of fiduciary duty as a director, except for liability resulting from a breach of the director's duty of loyalty to the Company or its stockholders, intentional misconduct or wilful violation of law, actions or inactions not in good faith, an unlawful stock purchase or payment of a dividend under Delaware law, or transactions from which the director derives improper personal benefit. Such limitation of liability does not affect the availability of equitable remedies such as injunctive relief or rescission. The Company's Certificate of Incorporation also authorizes the Company to indemnify its officers, directors and other agents, by bylaws, agreements or otherwise, to the

fullest extent permitted under Delaware law. The Company has entered into an Indemnification Agreement (the "Indemnification Agreement") with each of its directors and officers which may, in some cases, be broader than the specific indemnification provisions contained in the Company's Certificate of Incorporation or as otherwise permitted under Delaware law. Each Indemnification Agreement may require the Company, among other things, to indemnify such officers and directors against certain liabilities that may arise by reason of their status or service as a director or officer, against liabilities arising from willful misconduct of a culpable nature, and to obtain directors' and officers' liability insurance if available on reasonable terms.

The Company maintains a directors and officers liability policy with Genesis Insurance Company that contains a limit of liability of \$3,000,000 per policy year.

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Item 25. Other Expenses of Issuance and Distribution

It is estimated that the following expenses will be incurred in connection with the proposed offering hereunder. All of such expenses will be borne by the Company.

Registration fee - Securities and Exchange Commission.....	\$3,321.95
Nasdaq listing expenses.....	\$7,500.00
Legal fees and expenses.....	\$60,000.00
Accounting fees and expenses.....	\$60,000.00
Printing expenses.....	\$5,000.00
Miscellaneous expenses.....	\$5,000.00
Total.....	\$140,821.95

Item 26. Recent Sales of Unregistered Securities

The following sets forth certain information regarding sales of securities of the Company issued within the past three years, which were not registered pursuant to the Securities Act of 1933, as amended (the "Securities Act").

In May 1998, the Company completed a \$750,000 private placement of an aggregate of 375 shares of the Company's Series C Preferred Stock, par value \$0.01 per share ("Series C Preferred Stock") and 110,294 shares of Common Stock with institutional investors who had formerly invested in the Company. The 110,294 shares of Common Stock issued under this private placement were unregistered, restricted shares. The shares of Common Stock issuable upon conversion of the Series C Preferred are the subject of an effective registration statement of the Company.

In June 1998, the Company completed a \$1,000,000 private placement with an institutional investor who had formerly invested in the Company in which the Company issued 153,846 unregistered shares of Common Stock at a price of \$6.50 per share.

In December 1997, two employees of the Company exercised options granted to them for an aggregate of 150,000 shares of Common Stock. No shares have been issued under the Company's 1996 Omnibus Stock Option Plan and 1997 Stock Option Plan.

The securities listed above were (i) sold pursuant to exemptions from registration under Section 4(2) of the Securities Act and/or (ii) sold to persons who were neither nationals nor residents of the U.S., and no facilities or instrumentalities of U.S. interstate commerce were used in connection with any offer or sale thereof. No underwriter or underwriting discount or commission was involved in any of such sales.

Item 27. Exhibits and Financial Statement Schedules

The following exhibits are filed as part of this Registration Statement:

<TABLE>
<CAPTION>

Number	Description of Exhibit
-----	-----
<S>	<C>
1.1	Form of Financial Consulting Agreement between the Company and the Representative.*
3.1	Certificate of Incorporation of the Company, as amended.*
3.2	Bylaws of the Company (as amended on September 24, 1998).**

- 4.1 Warrant Exercise Fee Agreement.*
- 4.2 Form of Forfeiture Escrow.*
- 4.3 Form of specimen certificate for Common Stock.*
- 4.4 Form of Redeemable Warrant.*

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- 4.5 Subscription Agreement.
- 4.6 Form of Warrant.**
- 5.1 Opinion of Parker Chapin Flattau & Klimpl, LLP re: legality.
- 10.1 December 31, 1994 Acquisition Agreement between the Company and Tech Virginia.*
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- 10.6 March 22, 1996 Month-to-Month Tenancy Agreement between the Company and The Original Tollhouse Historical Preservation Company.*
- 10.7 October 27, 1994 Residential Deed of Lease between the Company and Frank E. and Heather H. Moxley.*
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- 10.9 January 5, 1995 Kopin Corporation contract.*
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- 10.18 April 4, 1996 Electronic Surveillance Technologies Corporation VAR agreement.*
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- 10.21 Business Loan Agreement, Promissory Note and Commercial Security Agreement by and between Fairfax Bank & Trust Company and the Company.*
- 10.22 Distributor Agreement with Hewlett-Packard B.V.***
- 10.23 May 19, 1998 Distribution Agreement with En Pointe Technologies Sales, Inc.*** 10.24 1998 Agreement with Sony Digital Products Inc.***
- 23.1 Consent of Parker Chapin Flattau & Klimpl, LLP (included in Exhibit 5.1).
- 23.2 Consent of PricewaterhouseCoopers LLP
- 24.1 Power of Attorney (included in signature page hereto).**

</TABLE>

- - - - -

- * Incorporated by reference to the exhibits filed with the registration statement on Form SB-2 (Commission file #333-04156).
- ** To be filed by amendment.
- *** Not filed herewith. Confidential treatment has been requested via a concurrent filing with the Commission pursuant to Rule 406 under the Securities Exchange Act.

Item 28. Undertakings

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement;

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; and

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(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof; and

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person of the Registrant in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes (i) to provide to the Underwriter at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the Underwriter to permit prompt delivery to each purchaser, (ii) that for purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act of 1933 shall be deemed to be part of this Registration Statement as of the time it was declared effective, and (iii) that for purposes of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form SB-2 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Fairfax, Commonwealth of Virginia on September 30, 1998.

XYBERNAUT CORPORATION

By: /s/ Edward G. Newman
Edward G. Newman
Chairman of the Board, President
and Chief Executive Officer

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POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each individual whose signature appears below constitutes Edward G. Newman and Steven A. Newman, each acting alone, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this registration statement and to file the same with exhibits

thereto, and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement on Form SB-2 has been signed below by the following persons in the capacities and on the date indicated.

<TABLE>

<CAPTION>

SIGNATURE -----	TITLE -----	DATE ----
<S> /s/ Edward G. Newman ----- Edward G. Newman	<C> Chairman of the Board, President and Chief Executive Officer	<C> <C> September 30, 1998 September 30, 1998
/s/ Kaz Toyosato ----- Kaz Toyosato	Executive Vice President Asian Operations and Director	September 30, 1998
/s/ Maarten Heybroek ----- Maarten Heybroek	Chief Operating Officer and Chief Financial Officer	September 30, 1998
/s/ Martin Eric Weisberg ----- Martin Eric Weisberg	Secretary and Director	September 30, 1998
/s/ Lt. Gen. Harry E. Soyster ----- Lt. Gen. Harry E. Soyster	Director	September 30, 1998
/s/James J. Ralabate ----- James J. Ralabate	Director	September 30, 1998
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/s/ Keith P. Hicks ----- Keith P. Hicks	Director	September 30, 1998
	Director	September 30, 1998
/s/Steven A. Newman ----- Steven A. Newman	Director	September 30, 1998
/s/Phillip E. Pearce ----- Phillip E. Pearce	Director	September 30, 1998
/s/ Eugene J. Amobi ----- Eugene J. Amobi	Director	September 30, 1998
/s/ Edwin Vogt ----- Edwin Vogt	Director	September 30, 1998

</TABLE>

By: /s/ Edward G. Newman

Edward G. Newman
Attorney-in-fact

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<TABLE>
<CAPTION>

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</TABLE>

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** To be filed by amendment.

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*** Not filed herewith. Confidential treatment has been requested via a concurrent filing with the Commission pursuant to Rule 406 under the Securities Exchange Act.

SUBSCRIPTION AGREEMENT

THIS SUBSCRIPTION AGREEMENT (the "Agreement") is made and entered into as of this _____ day of September, 1998, by and between Xybernaut Corporation, a Delaware corporation ("Xybernaut"), with offices at 12701 Fair Lakes Circle, Fairfax, Virginia 22033, and HSBC James Capel Canada, Inc., an Ontario company ("HSBC"), with offices at 105 Adelaide Street West, Suite 1200, Toronto, Ontario M5H 1P9, Canada, providing for the purchase and sale of shares of the common stock, par value \$.01 per share (the "Common Stock"), of Xybernaut, by HSBC or its designated affiliates (collectively with HSBC, the "Buyer").

Xybernaut and Buyer hereby represent and agree as follows:

1. Definitions.

(a) "Average Daily Price" shall be the price based on the VWAP of Xybernaut on the NASDAQ Small Cap Market.

(b) "Average Price" shall be the average of the Average Daily Price for the applicable Draw Down Pricing Period on the NASDAQ SmallCap Market.

(c) "Draw Down" shall have the meaning assigned to such term in Section 4(a) - hereof.

(d) "Draw Down Exercise Date" shall have the meaning assigned to such term in Section 4(b) hereof.

(e) "Draw Down Pricing Period" shall mean a period of five (5) consecutive trading days preceding a weekly Draw Down Exercise Date, a period of twenty (20) consecutive trading days preceding a monthly Draw Down Exercise Date and an agreed upon period of consecutive trading days preceding a quarterly Draw Down Exercise Date.

(f) "Effective Date" shall mean the date the Registration Statement of the Company covering the Shares being subscribed for hereby is declared effective.

(g) "Material Adverse Effect" shall mean any effect on the business, operations, properties or financial condition of Xybernaut that is material and adverse to Xybernaut and its subsidiaries and affiliates, taken as a whole and/or any condition, circumstance, or situation that would prohibit or otherwise interfere with the ability of Xybernaut to enter into and perform any of its obligations under this Agreement or the Warrant in any material respect.

(h) "Material Change in Ownership" shall mean that the officers and directors of Xybernaut shall own less than 20% of the outstanding Common Stock of Xybernaut.

(i) "Monthly Draw Down Pricing Period" shall mean a period of twenty (20) consecutive trading days preceding the monthly Draw Down Exercise Date.

(j) "Quarterly Draw Down Pricing Period" shall mean an agreed upon period of consecutive trading days preceding the quarterly Draw Down Exercise Date.

(k) "Registration Statement" shall mean the registration statement under the Securities Act of 1933, as amended, to be filed with the Securities and Exchange Commission for the registration of the Shares.

(l) "Securities" shall mean, collectively, the shares of Common Stock of Xybernaut being subscribed for hereunder, the shares of Common Stock issuable to Buyer upon exercise of the Option and the Warrants, the Option and the Warrants.

(m) "Shares" shall mean, collectively, the shares of Common Stock of Xybernaut being subscribed for hereunder and those shares of Common Stock issuable to Buyer upon exercise of the Option and the Warrants.

(n) "Threshold Price" is the lowest price that Xybernaut will issue new shares of Common Stock.

(o) "VWAP" shall mean the daily volume weighted average price of Xybernaut on the NASDAQ Small Cap Market as reported by Bloomberg Financial using the AQR function.

(p) "Warrants" shall have the meaning assigned to such term in Section 7 hereof.

(q) "Weekly Draw Down Pricing Period" shall mean a period of five (5) consecutive trading days preceding the weekly Draw Down Exercise Date.

2. Agreement to Subscribe; Pricing.

(a) For at least the twelve (12) month period beginning on the Effective Date of the Registration Statement, Buyer hereby subscribes for a total of up to Thirty-One Million, Two Hundred Thousand Dollars (\$31,200,000) of Xybernaut's Common Stock based upon weekly Draw Downs of Six Hundred Thousand Dollars (\$600,000) per weekly Draw Down, monthly Draw Downs of Two Million Four Hundred Thousand Dollars (\$2,400,000) per monthly Draw Down, and quarterly Draw Downs of Seven Million Two Hundred Thousand Dollars (\$7,200,000) per quarterly Draw Down, and a per share purchase price equal to the lesser of (i) 100% of the Average Price for the Draw Down Pricing Period and (ii) \$8.00 (the "Purchase

Price").

(b) If the Average Daily Price on a given trading day is less than the Threshold Price then Buyer's payment obligation under the Draw Down will be reduced by 1/5th, 1/20th or an agreed upon fraction for a weekly, monthly or quarterly Draw Down, respectively. At no time shall

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the Threshold Price be set below \$3.00; provided, however, that if trading in Xybernaut's Common Stock is suspended for more than three (3) hours in any trading day, the price of the Common Stock shall be deemed to be below the Threshold Price for that trading day.

3. Conditions Precedent. The parties recognize that all of the obligations set forth herein are subject to the following conditions:

(a) Xybernaut shall cause to be filed a Registration Statement, which Registration Statement shall provide for the resale of the Common Stock purchased by and issued to HSBC in accordance of this Agreement. Xybernaut shall cause the Registration Statement to be declared effective by the Securities and Exchange Commission (the "Commission") as expeditiously as practicable, and in any event prior to the initial Draw Down by Xybernaut.

(b) Before Buyer shall be obligated to accept a Draw Down request from Xybernaut, Xybernaut shall have caused a sufficient number of shares of Common Stock to be registered to cover the shares of Common Stock to be issued in connection with such Draw Down.

4. Draw Down Terms. Subject to the satisfaction of the foregoing conditions, the parties agree as follows:

(a) Xybernaut, may, in its sole discretion, issue and exercise a weekly, monthly or quarterly draw down (a "Draw Down") during any Weekly Draw Down Pricing Period, Monthly Draw Down Pricing Period or Quarterly Draw Down Pricing Period, which Draw Down Buyer will be obligated to accept.

(b) Only one Draw Down shall be allowed in each Draw Down Pricing Period. The Draw Down shall occur on the first trading day following the end of the Draw Down Pricing Period (the "Draw Down Exercise Date"), based on the Average Daily Price during the Draw Down Pricing Period.

(c) There shall be a maximum of 52 weekly Draw Downs, 12 monthly Draw Downs and 4 quarterly Draw Downs during the term of this Agreement.

(d) Xybernaut shall have the right to issue and exercise a weekly Draw Down of up to \$600,000 of Xybernaut's Common Stock per week, a

monthly Draw Down of up to \$2,400,000 of Xybernaut's Common Stock per month and a quarterly Draw Down of up to \$7,200,000 of Xybernaut's Common Stock per quarter, in each case for a period of 12 months.

(e) Subject to all restrictions being satisfied, the exercise a Draw Down will be automatic. Exercise will be "European Style" (i.e. the Draw Down can be exercised only on the Draw Down Exercise Date).

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(f) Each Draw Down will expire on the calendar day after the Draw Down Exercise Date.

(g) Xybernaut must inform Buyer via facsimile transmission as to the amount of the Draw Down Xybernaut wishes to exercise before the first day of the Draw Down Pricing Period (the "Draw Down Notice"). The closing bid price of the Common Stock on each Draw Down Exercise Date must be greater than \$3.00 per share as reported by the NASDAQ Small Cap Market. At no time shall Buyer be required to purchase more than the scheduled Draw Down amount for a given week, month or quarter so that if Xybernaut chooses not to exercise the Draw Down in a given week, month or quarter Buyer is not obligated to purchase more than the scheduled amount in subsequent weeks, months or quarters.

(h) On or before three trading days of the Draw Down Exercise Date, Xybernaut shall deliver the Shares purchased by Buyer to Buyer or to The Depository Trust Company ("DTC") on Buyer's behalf. Xybernaut and Buyer shall cause such Shares to be credited to the DTC account designated by Buyer upon receipt by Xybernaut of payment for the Draw Down into an account designated by Xybernaut. The delivery of the shares of Common Stock into Buyer's DTC account in exchange for payment therefor shall be referred to herein as "Settlement". Buyer shall coordinate Settlement with Xybernaut through DTC.

5. Buyer's Call Option. Buyer shall have the right to purchase an additional amount up to the maximum amount permitted to be drawn down for each Draw Down (the "Option"). For each additional amount that Buyer exercises its right pursuant to this Section, Buyer must notify Xybernaut in writing of such exercise no later than 5:00 p.m. (East coast time) on the last day of the applicable Draw Down Pricing Period. If Buyer so exercises its Option to purchase additional shares, the price for the shares of Common Stock shall be the VWAP for the Common Stock on the date Xybernaut furnishes Buyer with the Draw Down Notice. If Buyer does not exercise its right by such time on the last day of the applicable Draw Down Pricing Period, Buyer's right with respect to the applicable Draw Down Pricing Period shall terminate.

6. Restrictions. The parties agree as follows:

(a) A Registration Statement must be effective before the

first day of the Draw Down Pricing Period.

(b) Xybernaut must remain listed or admitted for trading, as applicable, on the NASDAQ Small Cap Market Systems, NASDAQ National Market Systems, the New York Stock Exchange or the American Stock Exchange for the entire Draw Down Pricing Period.

(c) Xybernaut is restricted from entering in any other financing agreement without the prior consent of Buyer or without terminating its agreement with Buyer, except that Xybernaut may enter into a loan or credit facility with a bank or financing institution, establish an employee stock option plan or finance the acquisition of other companies; provided that any shares of Common Stock

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or securities convertible into shares of Common Stock used to finance any acquisition shall constitute "restricted securities" under Rule 144 of the Securities Act of 1933, as amended (the "Securities Act"), except that Xybernaut may issue registered shares of Common Stock in connection with an acquisition. Xybernaut may terminate this Agreement upon not less than thirty (30) business days' notice to Buyer. Upon termination on the Agreement, Buyer will retain all Warrants previously received, but forfeit all unissued "Call" privileges granted pursuant to Section 5 hereof.

(d) No Draw Down will be permitted if there has been a Material Adverse Effect or Material Change in Ownership in Xybernaut.

(e) All cash payable to Xybernaut upon settlement of a Draw Down or the exercise of the Option shall be paid by Buyer to a mutually agreed upon escrow account against the concurrent delivery to the escrow agent of the escrow amount of the shares of Common Stock subject to the Draw Down or the exercise of the Option.

(f) At all times during the term of this Agreement there must be a minimum of eight active Market Makers for Xybernaut's Common Stock on the NASDAQ Small Cap Market or NASDAQ National Market Systems, as applicable, unless Xybernaut's Common Stock is listed on the New York Stock Exchange or the American Stock Exchange.

(g) All Draw Downs shall be settled on the Draw Down Exercise Date.

7. Warrants; Fees. The parties agree as follows:

(a) For each Draw Down, Buyer will receive warrants ("Warrants") to purchase 12,500 shares of Common Stock for each weekly Draw

Down, 50,000 shares of Common Stock for each monthly Draw Down and 150,000 shares of Common Stock for each quarterly Draw Down. Each Warrant will have a three (3) year life beginning six (6) months from the closing date of the Draw Down. Common Stock underlying the Warrants will be registered in the Registration Statement. If no Draw Down has occurred during a Draw Down Pricing Period, no Warrants will be issued to Buyer.

(b) The Warrant Strike Price shall be 225% of the Average Daily Price of the Common Stock on the date Xybernaut furnishes Buyer with the Draw Down Notice.

(c) Settdown Capital International, Ltd. ("Settdown") will receive a fee of 5% of the distribution total amount drawn down by Buyer. Xybernaut acknowledges that Settdown may use a portion of its fee to compensate other parties relative to a particular Draw Down.

(d) Xybernaut will incur all costs and expenses related to the transactions contemplated by this Agreement.

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8. Representations, Warranties and Covenants of Buyer. Buyer represents, warrants and covenants to Xybernaut as follows:

(a) This Agreement has been duly authorized, validly executed and delivered on behalf of Buyer and is a valid and binding agreement of Buyer enforceable in accordance with its terms, subject to general principles of equity and of bankruptcy or other laws affecting the enforcement of creditors' rights;

(b) Buyer has received and carefully reviewed copies of the Public Documents (as defined herein). No representations or warranties have been made to Buyer by Xybernaut, the officers or directors or Xybernaut, or any agent, employee or affiliate of any of them, except as specifically set forth herein or as set forth in documents referenced herein. Buyer understands that no federal or state governmental authority has made any finding or determination relating to the fairness of an investment in the Securities and that no federal or state governmental authority has recommended or endorsed, or will recommend or endorse, the investment herein. Buyer, in making the decision to purchase the Securities subscribed for, has relied upon independent investigation made by it and has not relied on any information or representations made by third parties;

(c) Buyer understands that the Securities are being offered and sold to it in reliance on specific provisions of federal and state securities laws and that Xybernaut is relying upon the truth and accuracy of the representations, warranties, agreements, acknowledgments and understandings of Buyer set forth herein;

(d) For as long as Buyer or any affiliate thereof is a holder of securities of Xybernaut, neither Buyer nor any affiliate shall, directly or indirectly, bid for, purchase, contract to buy, acquire any option to purchase or otherwise acquire any Common Stock, warrants or other securities of the Company in the open market or otherwise, except in accordance with this Agreement or directly from Xybernaut;

(e) Buyer is an "accredited investor" as defined under Rule 501 of Regulation D under the Securities Exchange Act of 1933; and

(f) Buyer is capable of evaluating the risks and merits of this investment by virtue of its experience as an investor and its knowledge, experience, and sophistication in financial and business matters.

9. Representations, Warranties and Covenants of Xybernaut. Xybernaut represents, warrants and covenants to Buyer as follows:

(a) Xybernaut has been duly incorporated and is validly existing and in good standing under the laws of the State of Delaware, with full corporate power and authority to own, lease and operate its properties and to conduct its business as currently conducted, and is duly registered and qualified to conduct its business and is in good standing in each jurisdiction or place

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where the nature of its properties or the conduct of its business requires such registration or qualification, except where the failure to register or qualify is not reasonably anticipated to have a Material Adverse Effect;

(b) Xybernaut has registered shares of its Common Stock pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and is in full compliance with all reporting requirements of the Exchange Act;

(c) Xybernaut has furnished Buyer with copies of Xybernaut's most recent Annual Report on Form 10-KSB (the "Form 10-KSB") filed with the Commission, its Form 10-QSB for the quarterly period ended June 30, 1998 (the "Form 10-QSB") (collectively with the Form 10-KSB and the Form 10-QSB, the "Public Documents"). The Public Documents at the time of their filing did not include any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements contained therein, in light of the circumstances under which they were made, not misleading;

(d) The Shares shall be duly authorized and validly issued and

when issued and delivered, will be fully paid and nonassessable;

(e) This Agreement has been duly authorized, validly executed and delivered on behalf of Xybernaut and is a valid and binding agreement of Xybernaut enforceable in accordance with its terms, subject to general principles of equity and to bankruptcy or other laws affecting the enforcement of creditors' rights generally, and Xybernaut has full power and authority to execute and deliver this Agreement and the other agreements and documents contemplated hereby and to perform its obligations hereunder and thereunder;

(f) The execution and delivery of this Agreement, the issuance of the Shares and the consummation of the transactions contemplated by this Agreement by Xybernaut, will not conflict with or result in a breach of or a default under any of the terms or provisions of, Xybernaut's certificate of incorporation or By-laws, or of any material provision of any indenture, mortgage, deed of trust or other material agreement or instrument to which Xybernaut is a party or by which it or any of its properties or assets is bound, any material provision of any law, statute, rule, regulation, or any existing applicable decree, judgment or order by any court, federal or state regulatory body, administrative agency, or other governmental body having jurisdiction over Xybernaut, or any of its properties or assets or will result in the creation or imposition of any material lien, charge or encumbrance upon any property or assets of Xybernaut or any of its subsidiaries pursuant to the terms of any agreement or instrument to which any of them is a party or by which any of them may be bound or to which any of their property or any of them is subject;

(g) Except as disclosed herein, no authorization, approval, filing with or consent of any governmental body is required for the issuance and sale of the Shares;

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(h) There is no action, suit or proceeding before or by any court or governmental agency or body, domestic or foreign, now pending against or affecting Xybernaut, or any of its properties, which would reasonably be anticipated to result in a Material Adverse Effect except as set forth in the Public Documents;

(i) Subsequent to the dates as of which information is given in the Public Documents, except as contemplated herein, Xybernaut has not incurred any material liabilities or material obligations, direct or contingent, or entered into any material transactions not in the ordinary course of business, and there has not been any change in its capitalization or any Material Adverse Effect; and

(j) Xybernaut has sufficient title and ownership of all

trademarks, service marks, trade names, copyrights, patents, trade secrets and other proprietary rights necessary for its business as now conducted and as proposed to be conducted as described in the Public Documents without any conflict with or infringement of the rights of others. Except as set forth in the Public Documents, there are no material outstanding options, licenses or agreements of any kind relating to the foregoing, nor is Xybernaut bound by or party to any material options, licenses or agreements of any kind with respect to the trademarks, service marks, trade names, copyrights, patents, trade secrets, licenses and other proprietary rights of any other person or entity.

10. Indemnification.

(a) Xybernaut hereby agrees to indemnify and hold harmless Buyer and its officers, directors, shareholders, employees, agents and attorneys against any and all losses, claims, damages, liabilities and expenses incurred by each such person in connection with defending or investigating any such claims or liabilities, whether or not resulting in any liability to such person, to which any such indemnified party may become subject under the Securities Act, or under any other statute, at common law or otherwise, insofar as such losses, claims, demands, liabilities and expenses arise out of or are based upon (i) any untrue statement or alleged untrue statement of a material fact made by Xybernaut (ii) any omission or alleged omission of a material fact with respect to Xybernaut or (iii) any breach of any representation, warranty or agreement made by Xybernaut in this Agreement.

(b) Buyer hereby agrees to indemnify and hold harmless Xybernaut and its officers, directors, shareholders, employees, agents and attorneys against any and all losses, claims, damages, liabilities and expenses incurred by each such person in connection with defending or investigating any such claims or liabilities, whether or not resulting in any liability to such person, to which any such indemnified party may become subject under the Securities Act, or under any other statute, at common law or otherwise, insofar as such losses, claims, demands, liabilities and expenses arise out of or are based upon (i) any untrue statement or alleged untrue statement of a material fact made by Buyer, (ii) any omission or alleged omission of a material fact with respect to Buyer or (iii) any breach of any representation, warranty or agreement made by Buyer in this Agreement.

11. Publicity. Neither Xybernaut nor Buyer shall issue any press release or make any other public announcement relating to this Agreement which has not been mutually agreed to by Xybernaut and Buyer. Neither party shall unreasonably withhold its agreement to the text of any such proposed press release or other public announcement.

12. Term. The term of this Agreement shall be twelve (12) months from

the initial Draw Down, unless earlier terminated by either party or extended by mutual consent of the parties.

13. Governing Law. This Agreement shall be governed by and interpreted in accordance with the laws of the State of Delaware without giving effect to the rules governing the conflicts of laws.

14. Expenses. Each of the parties agrees to pay its own expenses incident to this Agreement and the performance of its obligations hereunder, except that Xybernaut will pay the reasonable fees and expenses of Buyer's legal counsel.

15. Notices. All notices and other communications provided for or permitted hereunder shall be made in writing by hand delivery, express overnight courier, registered first class mail, overnight courier, or telecopier, initially to the address set forth below, and thereafter at such other address, notice of which is given in accordance with the provisions of this Section.

if to Xybernaut:

Xybernaut Corporation
12701 Fair Lakes Circle
Fairfax, Virginia 22033
Attn: Edward G. Newman
President and Chief Executive Officer
Telephone: (703) 631-6925
Telecopier: (703) 631-6734

with a copy to:

Parker Chapin Flattau & Klimpl, LLP
1211 Avenue of the Americas
New York, New York 10036
Attn: Martin Eric Weisberg, Esq.
Telephone: (212) 704-6000
Telecopier: (212) 704-6288

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if to Buyer:

HSBC James Capel Canada, Inc.
105 Adelaide Street West
Suite 1200
Toronto, Ontario M5H 1P9 Canada
Attn: Isser Elishis
Telephone: (416) 947-2700
Telecopier: (416) 947-9450

All such notices and communications shall be deemed to have been duly given: when delivered by hand, if personally delivered; three (3) business days after being deposited in the mail, postage prepaid, if mailed; the next business day after being deposited with an overnight courier, if deposited with a nationally recognized, overnight courier service; when receipt is acknowledged, if telecopied.

15. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral or written proposals or agreements relating thereto. This Agreement may not be amended or any provision hereof waived in whole or in part, except by a written amendment signed by both of the parties.

16. Counterparts. Agreement may be executed by facsimile signature and in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, this Agreement was duly executed on the date first written above.

Xybernaut Corporation

By:

Name: Steven A. Newman
Title: Vice Chairman

HSBC James Capel Canada, Inc.

By:
Name:
Title:

LETTERHEAD OF PCFK

September 30, 1998

Xybernaut Corporation
12701 Fair Lakes Circle
Fairfax, Virginia 22033

Ladies and Gentlemen:

We have acted as counsel to Xybernaut Corporation (the "Company") in connection with a Registration Statement on Form SB-2 filed by the Company with the Securities and Exchange Commission (the "Registration Statement") relating to up to 2,002,000 shares (the "Shares") of the Company's Common Stock, par value \$0.01 per share (the "Common Stock"). Of such Shares, 105,000 may be issued upon the exercise of warrants which may be issued to the holders of the Shares (the "Warrants").

In connection with the foregoing, we have examined, among other things, the Registration Statement, the Subscription Agreement, the Warrants and originals or copies, satisfactory to us, of all such corporate records and of all such agreements, certificates and other documents as we have deemed relevant and necessary as a basis for the opinion hereinafter expressed. In such examination, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals and the conformity with the original documents submitted to us as copies. As to any facts material to such opinion, we have, to the extent that relevant facts were not independently established by us, relied on certificates of public officials and certificates, oaths and declarations of officers or other representatives of the Company.

Based upon the foregoing, we are of the opinion that (i) the Shares, when issued pursuant to the Subscription Agreement, will be legally issued, fully paid and non-assessable; and (ii) the Shares issuable upon the exercise of the Warrants (when such Shares are paid for and issued in accordance with the terms of the Warrants) will be legally issued, fully paid and non-assessable.

We hereby consent to the use of our name under the caption "Legal Matters" in the Prospectus constituting a part of the Registration Statement and to the filing of a copy of this opinion as an exhibit.

Very truly yours,

/s/ PARKER CHAPIN FLATTAU & KLIMPL, LLP

Consent of Independent Accountants

We consent to the inclusion in this registration statement of Xybernaut Corporation on Form SB- 2 of our report, which includes an explanatory paragraph concerning the Company's ability to continue as a going concern, dated March 31, 1998, on our audits of the consolidated financial statements of Xybernaut Corporation as of December 31, 1997 and 1996, and for the years then ended. We also consent to the references to our firm under the captions "Selected Financial Data" and "Experts". However, it should be noted that PricewaterhouseCoopers LLP has not prepared or certified such "Selected Financial Data".

McLean, Virginia
September 29, 1998

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