



Nikki

Nikki Chung
Nam D Vietnamese Street Food
Xero Customer, Wellington NZ



**BORN IN THE CLOUD, XERO'S MISSION
IS TO REWIRE THE GLOBAL ECONOMY...**

... connecting millions of businesses to their
banks, advisors and each other.

The total lifetime value of Xero subscribers
at 31 March 2018 is

\$3.2

b

Up 45% from
last year

WITH THESE ANNUAL RESULTS, XERO BEGINS THE NEXT CHAPTER IN ITS GLOBAL GROWTH STRATEGY



Josh
Josh Mihan
The Bearded Man
Xero Customer
Melbourne, AU

**AFTER 12
YEARS OF
INVESTING
IN GROWTH,
XERO HAS
DELIVERED
ITS FIRST
POSITIVE
EBITDA**

**WHILE DELIVERING A 38%
INCREASE IN OPERATING
REVENUE**

OVER THE
12 MONTHS
TO 31 MARCH
2018, XERO
DELIVERED:

OPERATING REVENUE

\$406,579,000



UP 38%
YOY

EBITDA

\$26,006,000



UP \$54.6M
YOY

GROSS MARGIN

81%



UP 4pp*
YOY

*pp stands for percentage points

AN ENDLESS HORIZON AHEAD

The last 12 years and Xero's next chapter

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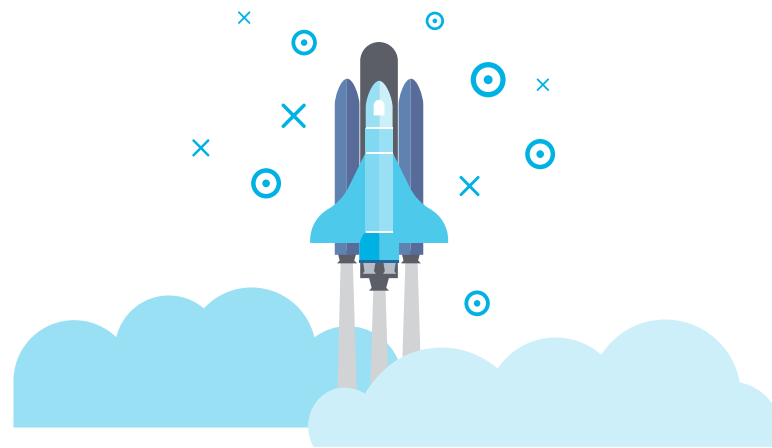
AN
ENDLESS
HORIZON
AHEAD

Graham

Graham Smith
Xero Chair



CHAIR'S REVIEW



Dear shareholder

Xero is in a unique and enviable position to embark on its next chapter of global growth. My comments largely focus on strategy, as it has been a relentless commitment to executing a clear strategy that has driven us to this point in our journey. It will be the same, disciplined focus on strategy and execution that will allow Xero to realise its considerable potential as we enter the next chapter of growth.

As Rod Drury discusses in the CEO review, Xero's future will be as a truly global, cloud-based business platform. You can expect to see this reflected not only in product development but also in our geographic market strategy, continuing our near term focus on English language markets.

SUCCESSION PLANNING IN ACTION

One of the Board's primary accountabilities is to appoint the Chief Executive. We have been privileged and fortunate to have had Xero's founder Rod Drury in this role since he founded the company 12 years ago.

Steve Vamos took over as Xero's Chief Executive on 1 April this year and the Board welcomes him to Xero. Steve has a leadership track record in some of the world's most iconic technology companies, including Apple, IBM, and Microsoft. He also has a deep understanding of high-growth companies, having worked with start-ups, including ninemsn in Australia, which he grew into an industry leader.

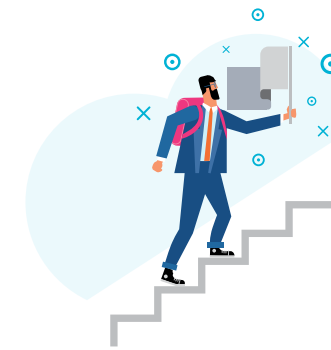
Steve brings an invaluable skill set to lead Xero. He understands the Xero business and the scale of the opportunity.

In the 18 months before he was appointed CEO, Steve worked as a consultant alongside Xero's leadership team in developing management capability, and honing Xero's operating model.

Steve's appointment underpins Xero's evolution from a founder-led company to a business with worldwide scale. Steve has the experience, capability and commitment we need to grow Xero, and the Board is delighted to have secured somebody of his calibre for this critical role.

ROD DRURY: THE FIRST XERO

At the same time, Xero will continue to benefit from Rod's vision and deep commitment to developing beautiful business products and to Xero's continued success, in his role as a non-executive director on the Board.



Rod's achievement of building a global company and community from New Zealand is unmatched. Through passion, commitment and sheer hard work, Rod has turned a good idea into one of the world's most innovative technology companies. He has worked tirelessly to build Xero and its culture so that we now have a solid base to begin our next phase.

Rod has made an enormous contribution to Xero, to New Zealand, and to international business. On behalf of the Board and the whole Xero team, I want to thank Rod and acknowledge his tremendous leadership since founding the company. Likewise, the Board looks forward to continuing to work with Rod in his role as a non-executive director.

BOARD UPDATE

We were also pleased to welcome Dale Murray, CBE, as a non-executive director to the Board in April. Recruiting a UK-based director is in line with our strategic focus on that market as one of Xero's growth engines. To attract Dale to Xero's Board is testament to our growing reputation around the world.

CONSOLIDATION OF OUR LISTING ON THE ASX

The recent consolidation of Xero's listing solely on the Australian Securities Exchange (ASX) and de-listing from the New Zealand Stock Exchange (NZX) is a reflection of our strategy in action.

As Xero continues to grow, having enhanced access to deeper capital markets, increased trading liquidity, and a broader base of potential investors is critical to fulfilling our aspirations and improving our visibility as a listed company.

Between 5 February 2018 (the date of our sole ASX listing) and 29 March 2018, average daily liquidity has increased by more than 200% and we've seen an increase in international index-based investment. In addition, on 9 March 2018, Xero was included in the S&P/ASX 100 index.

THE NEXT TWO YEARS

Over the next 18 – 24 months we will focus on delivering continued strong growth within the core business, and developing products, markets and capabilities that execute on our strategy.

We will do this while maintaining a nimble culture and environment that enables people to do the best work of their lives. This involves careful adherence to the right strategy and continuing to develop our people, products and partnerships.

CONCLUSION

Xero is uniquely positioned to forge ahead on its next chapter. It has the right people, the right strategy and significant opportunities ahead.

As a shareholder, you should expect our company to continue on our journey with exactly what has got us to this moment: passion, vision, innovation, beautiful products, and a relentless commitment to our customers through disciplined strategy and execution.

On behalf of the Xero Board, thank you for your continued support.

Graham Smith
Chair



Rod
Rod Drury
 Founder

**XERO'S NEXT
 CHAPTER**

CEO'S REVIEW

Dear shareholder

The completion of Xero's financial year to 31 March 2018 represents the beginning of the next chapter of Xero's evolution as one of the world's most innovative technology companies.

STRATEGY DELIVERS GROWTH, RESULTS

We are pleased to announce Xero's first positive annual EBITDA result of \$26.0 million and Annualised Monthly Recurring Revenue (AMRR) growth of 33 percent to \$484.4 million for the financial year ended 31 March 2018, which we have achieved while driving significant subscriber growth. This represents a profound milestone for our company, and is a result the Xero team and our shareholders can be proud of.

These results have taken more than a decade of strategy execution and responsible investment of shareholder funds into research and development, and channel development, to balance extraordinary growth, operating metrics, and long-term value creation. As we signalled at our half year result, Xero's organic growth will soon be funded from our own free cash flows – the next stage of our journey will be one in which we are self-funding and focussed on realising the long-term opportunities that we are well positioned to secure.

Our focus on people, culture and capabilities, product innovation, and our unique relationship with customers and partners has created an exciting, active and passionate small business ecosystem whose momentum is driving our expansion around the world.

We entered the cloud-based software-as-a-service (SaaS) sector at the right time and have designed and built a beautiful business platform, brand, and community that our customers and partners love.

Xero was born in the cloud and is built on a single code base, and, as such, our business has no legacy 'desktop' installations that require migration to the cloud. We now stand on the foundations of a robust, highly defensible business with a proven track record. We have earned the right to manage the key system of record for millions of small businesses and to be the technology platform for accountants and bookkeepers to manage their relationships with their valued customers.

To understand the scale of the Xero platform, as at 31 March 2018, Xero:

- had 1.386 million subscribers in 180+ countries
- recorded \$2.15 trillion in transactions across the platform in the year to 31 March 2018*

While we've built the platform and the business for long-term success, we've also delivered strong results - growing from \$134,000 of revenue in 2008 to now more than \$100 million a quarter.



1.386M

Xero had 1.386 million subscribers in 180+ countries as at 31 March 2018



\$2.15T

Xero recorded \$2.15 trillion in transactions across the platform in the year to 31 March 2018*

*Incoming and outgoing transactions, 12 month period

How we think about our future starts with our mission:
“To rewire the global economy, connecting millions of businesses to their banks, advisors and each other.”

THE SCALE OF THE OPPORTUNITY: REWIRING THE SMALL BUSINESS ECONOMY

To understand how Xero thinks about its future, it starts with our mission: “Xero’s mission is to rewire the small business economy, connecting millions of businesses to their banks, advisors and each other.”

Xero is at the forefront of what promises to be a significant change in the relationships between banks, financial institutions, financial advisory services, and accountants. This change will help to drive the global growth of small businesses.

BEAUTIFUL BUSINESS

Xero is evolving from a back-office accounting platform to a small business platform. There is significant potential in terms of products, services and solutions that we are able to create and extend to small businesses to help them more effectively manage their businesses. Likewise, we have an enormous opportunity to supply more services and value to our Xero partners.

Reflecting this evolution to a small business platform, and consistent with beginning the next chapter, customers will soon see a refreshed Xero brand position in the market. This will be ‘beautiful business’ - a recognition of the role small businesses, our partners and Xero play in building a better world. It will also portray Xero’s commitment to continue providing a powerful business platform that makes doing business easier.

MY NEW ROLE ON XERO’S BOARD

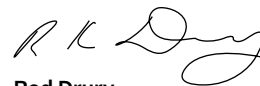
Xero plans relentlessly for success. This includes planning for succession and ensuring the right people are in the right roles to execute the company’s strategy.

In March this year, I announced my intention to step down as Xero’s Chief Executive at the end of the financial year. This was a carefully considered step made possible by the strength of the leadership team we have developed over the past few years as we transition from a founder-led company to a globally distributed, world class technology business scaling on multiple fronts. I’m excited to continue my contribution to strategy and passion for innovation as a non-executive director on the Xero Board while our strong leadership team focuses on the global operational disciplines and a distributed operating model that will drive our next chapter. I have loved every day of my journey as Xero’s leader and I’m so proud that we have built an amazing team of people and a passionate community.

Our new CEO Steve Vamos has the global operational experience to lead Xero as CEO through this next exciting period. Our company has everything it needs to succeed. The right people, the right strategy, the right vision, and unbounded opportunity.

To everybody who has been a part of this journey with us over the past decade, thank you for your contribution to Xero, and for your friendship, commitment and support.

To our valued customers, staff, shareholders, and partners, thank you for your support of Xero in reaching this point. We look forward to embarking on this next chapter together.



Rod Drury
Founder

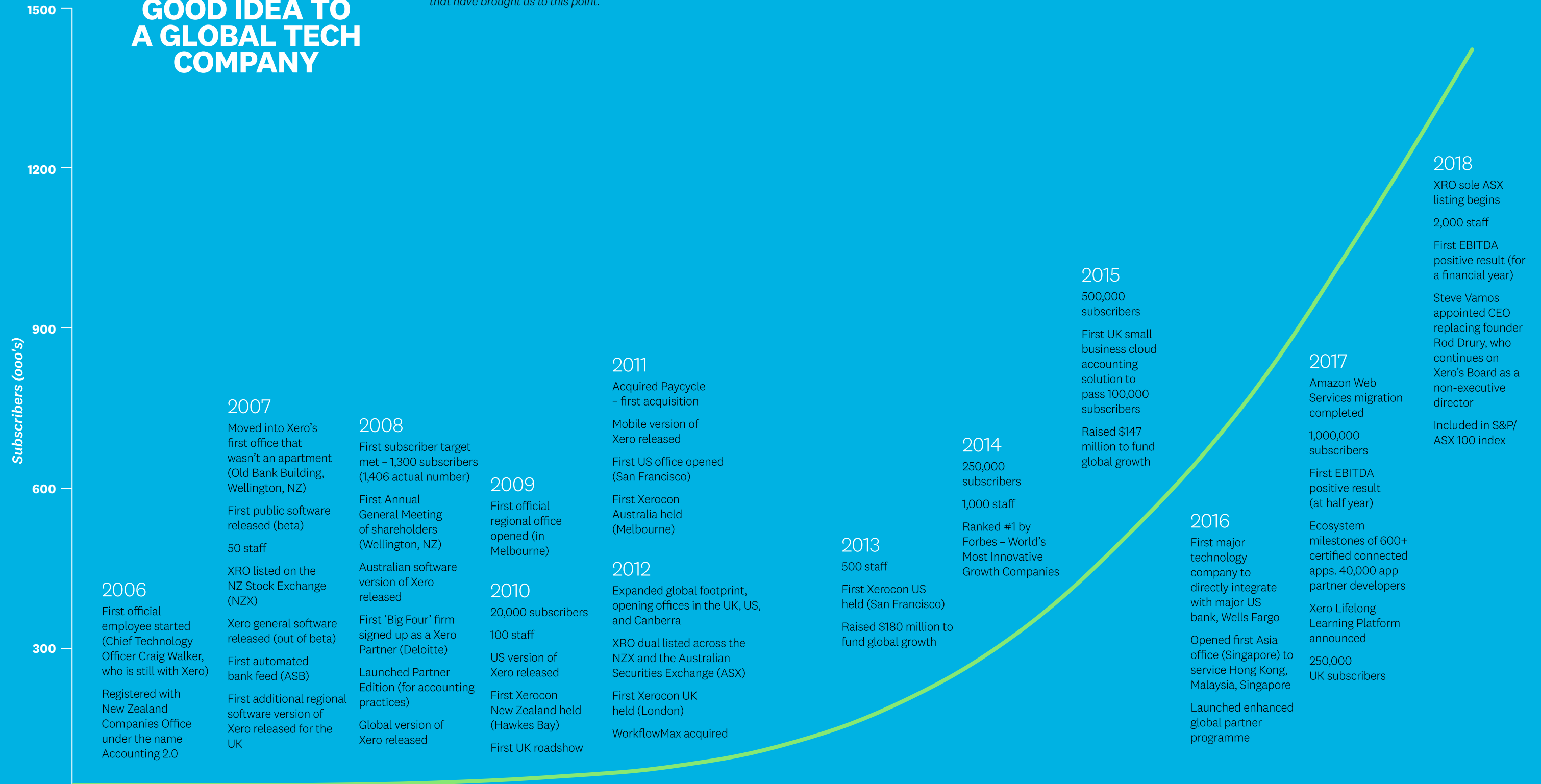
FROM GOOD
IDEA TO
GLOBAL
COMPANY



THE XERO
JOURNEY

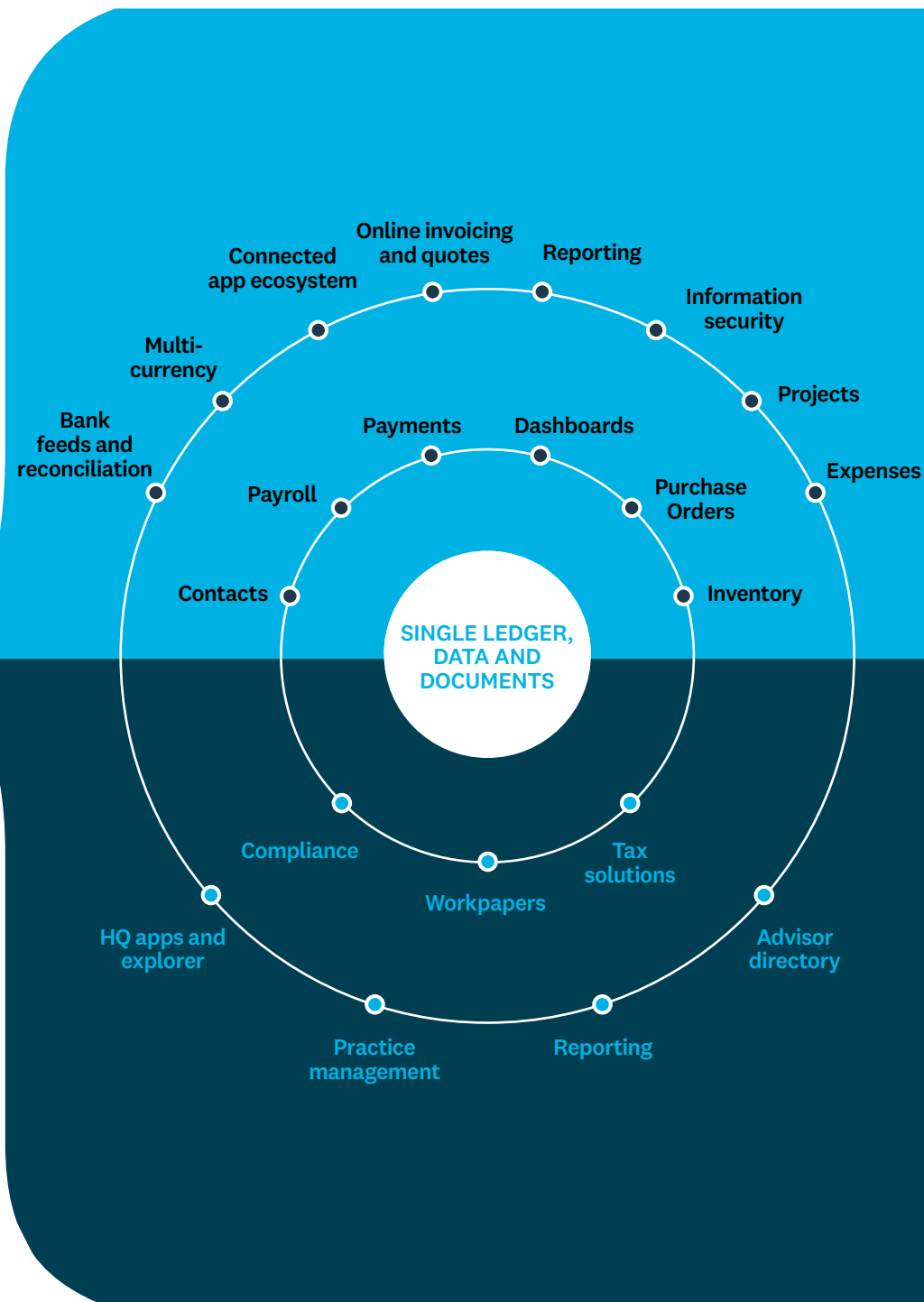
THE 12 YEAR JOURNEY OF A GOOD IDEA TO A GLOBAL TECH COMPANY

As we embark on the next chapter of Xero's journey it is worth celebrating some of the highlights and milestones that have brought us to this point.



A UNIQUE PLATFORM THAT CONNECTS SMALL BUSINESSES AND THEIR ADVISORS

Born in the cloud, Xero is a beautiful, easy-to-use global online platform for small businesses and their advisors. This next chapter is the shift from beautiful accounting software to a global small business platform, introducing new product features and continuing to revolutionise how small businesses manage their day-to-day activities, on one platform. This will bring us a step closer to fulfilling our mission: to rewire the global economy, connecting millions of businesses to their banks, advisors and each other.



FOR SMALL BUSINESS

Small businesses can manage their day-to-day finances with software that's smart and easy to use, having instant access to their data and files

FOR ACCOUNTING PARTNERS

Accounting partners can connect their clients' data and work efficiently, bringing various work streams of their practice on to one platform in the cloud



DEEPER PENETRATION
IN EXISTING MARKETS
AND GEOGRAPHIC
EXPANSION



ADJACENT
PRODUCTS FOR
SMALL BUSINESSES



TRANSACTIONAL
ACTIVITIES



FINANCIAL WEB



DATA DRIVEN
SOLUTIONS



GROWTH DRIVERS

MEASURING SOFTWARE AS A SERVICE (SAAS) COMPANIES

SaaS companies operate on many of the same performance metrics as traditional companies, such as revenue, cash flow, and customer numbers. Understanding the performance of SaaS companies, and being able to benchmark them requires an understanding of SaaS-specific metrics. Below we explain a handful of the headline metrics we use every day to manage and drive Xero's performance.

THE CLOUD

The cloud is essentially a network of computer servers that allows users to access their data through the internet, from any computer or mobile device, anywhere, at any time.

Cloud computing is where a company like Xero uses a network of computers to store and process information so rather than our customers needing to install software on a single machine or hard drive, they can access it through their web browser or mobile app.

SUBSCRIBERS

For Xero, 'subscriber' means each unique subscription to a Xero-offered product that is purchased by an accounting partner or an end-user and which is, or is available to be, deployed.

CUSTOMER ACQUISITION COST (CAC)

CAC are the costs incurred to secure a new subscriber. These costs include upfront investments in sales and marketing.

AVERAGE REVENUE PER USER (ARPU)

ARPU is a key number in determining the value of SaaS companies and is calculated by dividing Monthly Recurring Revenue (MRR) by subscriber numbers at the end of a period. To grow revenue, Xero can either add more subscribers or increase ARPU. By adding new products and functionality, ARPU can be increased as more value is provided to subscribers.

CAC MONTHS

CAC months represent the number of months of average revenue per user (ARPU) required to recover the cost of acquiring each new subscriber.

ANNUALISED MONTHLY RECURRING REVENUE (AMRR)

AMRR is a 12 month forward view of recurring revenue components of a SaaS business at a point in time. For Xero, it represents MRR at 31 March, multiplied by 12.

AMRR assumes promotional discounts have ended and other factors such as subscribers, pricing, and foreign exchange remain unchanged during the year. Twelve months worth of revenue is counted regardless of what

day a subscriber signs up to Xero. This differs to statutory reported revenue, where revenue is calculated on the periods of the subscription and net of discounts. For example, if a subscriber signed up to Xero using a promotion on the last day of a period, one day of revenue is recognised at the promotional rate, compared to 12 months of undiscounted revenue recognised as AMRR.

AMRR replaces the metric Xero has historically reported - Annualised Committed Monthly Revenue (ACMR). ACMR included recurring revenue resulting from a subscriber's subscription. AMRR includes other revenue streams, related to subscriber activity but not necessarily linked to a Xero subscription.

MRR CHURN

The best way to measure churn is through revenue rather than the number of subscribers. MRR churn is the amount of MRR attached to subscribers that have left Xero in the previous 12 months, reported as the average monthly churn over the period.

LIFETIME VALUE (LTV)

LTV is a key measure of the value a subscriber represents to a SaaS company over the subscriber's lifetime. A simple way to calculate the average lifetime of subscribers is one divided by churn.

LTV is calculated by dividing ARPU over the monthly churn rate to get the total revenue expected from an average subscriber, then multiplied by the gross margin percentage to get total gross margin expected per subscriber.

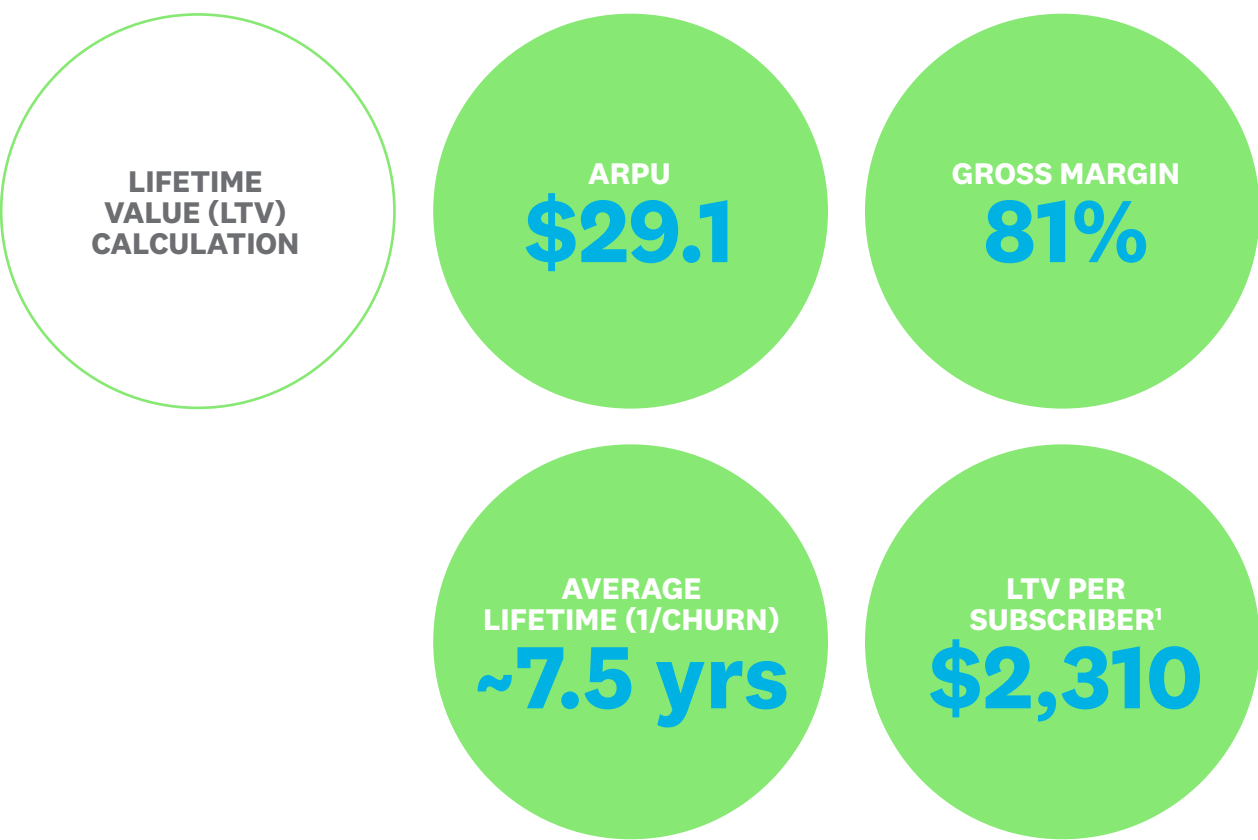
There are multiple ways to improve LTV, such as enhancing products and services to existing subscribers to increase ARPU, improving efficiencies in costs, and investing in retaining customers.

LTV of a subscriber can indicate potential future margins, whether the SaaS company is acquiring the right customers, and provides a strong signal to investors as to what they should expect as the company scales.

LTV/CAC

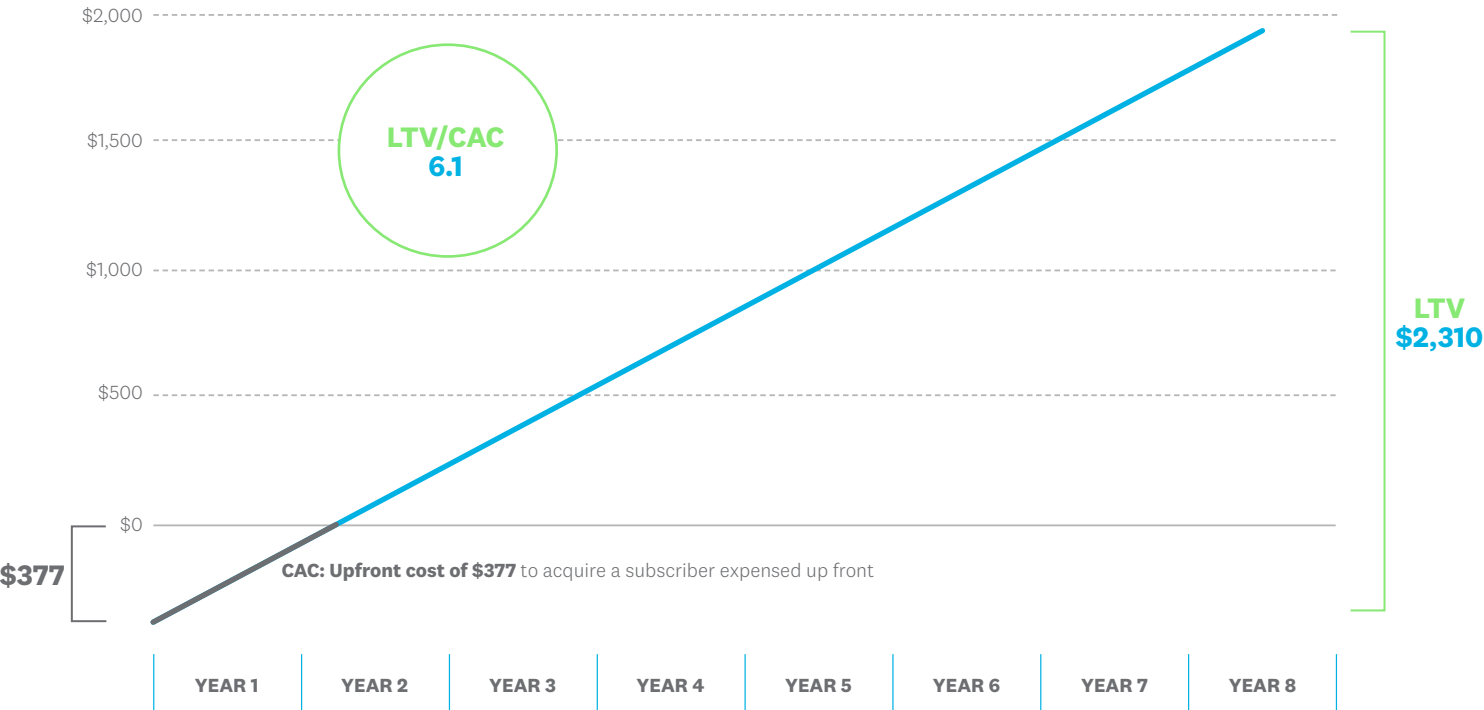
The LTV of the subscriber divided by the cost of acquisition per subscriber. This metric gives the gross margin of a subscriber's lifetime as a multiple of the cost of acquisition. A LTV/CAC ratio of 1.0 would mean margins over the lifetime just cover the cost to acquire the subscriber.

As SaaS businesses develop scale, the benefits of strong fundamental metrics become clear, as upfront investment to acquire in year one drives clear long term cumulative lifetime value.



¹Calculated as the sum of Xero's individual segment LTVs, multiplied by their respective segment subscribers, divided by total Group subscribers

VALUE OF A SAAS SUBSCRIBER²



²Represents cumulative margins less costs to acquire a subscriber

INSIGHTS INTO
AN AMBITIOUS
INNOVATIVE
CULTURE

3
INSIDE-
OUT
CULTURE

Kavithya

Kavithya Senthilnathan
Customer Experience Specialist
Wellington, NZ

GRACE

Grace Kreft
Sweet Bakery & Cakery
Xero Customer
Wellington, NZ

Jules

Jules Desmond
UX Research Producer
Wellington, NZ



PEOPLE AND CULTURE IN XERO'S NEXT CHAPTER

Building and maintaining an ambitious, innovative culture in a company that's been growing as fast as we are has little to do with chance. In fact, it's Xero's people and culture that has propelled us from one country to more than 180, one subscriber to nearly 1.4 million, and one person's idea to a global team of more than 2,000 people. **Here's how we've achieved it.**

OUR INSIDE-OUT APPROACH

Xero's Chief Customer and People Officer Rachael Powell is accountable for the 'human experience' at Xero. This is all about attracting the best people to our global business and creating a culture where all Xero people (internally known as Xeros) can do the best work of their lives. When we get this right, our people focused culture resonates from the inside-out, ultimately delighting and delivering to our number one priority – our more than one million customers and partners across the world.

PURPOSE-DRIVEN AT HEART

Fundamental to our culture is that all Xeros believe in our purpose which is to 'have a positive impact on the world by growing small business.' The power of this purpose cannot be overstated. It provides a unifying energy that brings our people, our partners and our customers together to do their best work, and collectively we achieve great things.

We want our people to thrive and do their best work. If we can help small businesses be more successful, more jobs are created, economies strengthen, and communities flourish. This highlights just how #beautiful the inside-out approach can be.

FUTURE-PROOFING THE 'XERO MAGIC'

At Xero, our five values underpin everything we do: from the way we work, to how we delight and deliver to our customers.

Our values are: #Human #Ownership #Champion #Challenge and #Beautiful. They create our special culture and the 'Xero magic' that we want to foster and maintain as we scale and grow at speed. They are integral to our brand and resonate outside Xero through our ecosystem and ultimately our customers.

Gil

Gil Albazi
Internal Client Support
Engineer, US



Caitlin

Caitlin Clarke
Producer, UK



Eric

Eric Agyeman
Small Business Specialist,
AU



Zaret

Zaret Espino
Sales Coordinator, US



Ange

Angela Dodd
Senior Customer
Experience Specialist, NZ



Joe

Joe Melton
Lead Designer, UK



#challenge



Jacqui

Jacqui Wales
Senior Producer, UK

#challenge

Andrew

Andrew Mackay
Front of House, AU



Ting

Ting Fu
Senior Customer
Experience
Specialist, AU



#beautiful



Nicki

Nicki Curtis
Product Owner, AU

Mia

Mia Voight
Learning Systems Support, US



#human



ADAM

Adam Yee
Senior Front End Engineer, US

Israel

Israel Peters
Video Producer, UK



#ownership



Kandarp

Kandarp Jani
Digital Optimisation Lead, UK

Sneha

Sneha Jagtap
Financial Web Partner
Manager, AU



Keryn

Keryn Kalyan
Business Improvement
Specialist, NZ



ZUBAIR

Zubair Mohammad
EMEA Marketing
Manager, UK

POISED WITH
THE RIGHT
SKILLS AND
PEOPLE FOR
GROWTH

AGILITY, AUTONOMY AND OWNERSHIP

We're mindful that our world, and our industry in particular, is characterised by rapid change and disruption – we're often the cause of it. Success depends on being agile, adaptable, and more innovative than ever before.

We have technology that enables and empowers our people to work with autonomy, speed, and flexibility in their roles. They can work from anywhere at anytime across the world. Likewise, our offices are designed as activity based workspaces that allow our people freedom to work in the way that suits them best. Whether that's collaborating, innovating, or focusing in a quiet space.

We also enable our people to take ownership in our company, giving all permanent Xeros the opportunity to be shareholders. This helps foster a personal commitment to and accountability for Xero's success.

PULSE CHECK ON CULTURE

We constantly monitor staff engagement using software that provides regular pulse checks across multiple dimensions of employee satisfaction. We respond directly to this feedback and use this quality data to actively address and manage any people and culture issues in the business. Xero maintains a level of staff engagement that is best in class across our industry.

DIVERSITY AND INCLUSION

At Xero, we have an unwavering focus on diversity and inclusion. It creates better outcomes for our people and our customers. We have a diverse customer base so it's essential we build products that speak directly to them. For our people, it's about acknowledging, respecting and celebrating all the ways they are different. It's also about creating an inclusive culture so we can really tap into the power of our differences.

On this front, we have concentrated our efforts over the past 12 months and have appointed a Head of Diversity, Inclusion and Community. And, to provide us with a clear focus for the future, we developed a new policy with six key principles:

1. We value diversity because it reflects and serves our customers and ensures our people thrive
2. We're all accountable to create an inclusive culture
3. We're committed to attracting diverse talent and hiring fairly
4. We support flexible ways of working
5. We're committed to equal pay for equal work
6. We have an obligation to champion diversity and inclusion in the community

While we know diversity is a broad concept, we are particularly focused on increasing our gender diversity. Currently the Xero Board is 43 percent female and as at 31 March 2018, our leadership team is 40 percent female, and of all of our Xero people around the world, 40 percent are female.

OUR PEOPLE AND THE NEXT CHAPTER

Building a global business where our people and culture are a source of competitive advantage is no easy feat. However, at Xero, this is our constant and unyielding focus. Everything begins with our people, to ensure that they can do their best work at Xero, to delight our customers, and ultimately to deliver on our promise to ensure small businesses across the globe are successful.

XERO
BOARD OF
DIRECTORS



From left to right:

Graham Smith
Chair of The Board

Rod Drury
Director

Lee Hatton
Director

Dale Murray, CBE
Director

Susan Peterson
Director

Bill Veghte
Director

Craig Winkler
Director

Graham Smith

Independent Director since February 2015 and Chair since January 2017

Graham has more than 25 years of finance experience in the software and SaaS industry. He was Chief Financial Officer at Salesforce from 2008 to 2014. He has held executive positions at Advent Software, Vitria Technology, Nuance Communications, and Oracle. Graham also serves on the Board of directors at Splunk, MINDBODY, BlackLine and Citrix. Graham also gets involved in his local community, as evidenced by his Board membership on the Sonoma Valley Education Foundation.

Rod Drury

Director since July 2006

For more than a decade, Rod led Xero from humble beginnings with four employees working in a Wellington apartment to a global software business and S&P/ASX 100 company. Rod started his career at Ernst & Young and went on to establish and lead a number of innovative technology businesses that were subsequently acquired. Rod was an independent director on the NZX Board and the Trade Me Board, through its acquisition by Fairfax. At the Deloitte Top 200 Awards 2017, Rod was named Visionary Leader of the Year. He was named EY New Zealand 100 Entrepreneur of the Year 2013, and is a member of the New Zealand Hi-Tech Hall of Fame.

Lee Hatton

Independent Director since April 2014

Lee is an executive with extensive experience across New Zealand, Australia, the UK and the US. After moving to Australia in 2012 to lead NAB's Group Regulatory function, in 2015 Lee became the Chief Executive Officer of UBank where she is accountable for the

business's strategy and performance. Lee believes creating a growth culture, centred on customers, is the true disruptor of companies, and she has led large distribution teams throughout her career leveraging this philosophy. Recognised for her collaboration abilities and experience blending technology innovation and financial services, Lee is also an executive director of NAB Ventures and a non-executive director of BLD Group PTY Ltd. Lee is involved in the community and enjoys mentoring individuals, especially in relation to the future of work.

Dale Murray, CBE

Independent Director since April 2018

Dale is a technology entrepreneur and growth-company advisor. Dale co-founded mobile pioneer Omega Logic in 1999, which co-launched prepay top-ups in the UK. She led the growth of top-up transactions to £450m within five years, generating net revenue of £25 million. After selling the company in a trade sale, she turned to investing and advising start-ups and won the British Angel Investor of the Year award in 2011. Dale is currently a non-executive director at Sussex Place Ventures, a non-executive director and Trustee for the Peter Jones Foundation, and a Board Advisor to Seedrs. She served on the Business Taskforce on EU Redtape for the Prime Minister in 2013.

Susan Peterson

Independent Director since February 2017

Susan is an experienced independent director on both ASX and NZX listed companies. She is currently an independent director of Trustpower, Vista Group, and Property for Industry. Susan is also a director of ASB Bank. Susan is a member of the New Zealand Markets Disciplinary Tribunal, was a past

Ministerial Appointee to The National Advisory Council for the Employment of Women, and has also been a long-serving member of the Board of IHC. Susan is founding co-chair and a shareholder in fast growing health and wellness start-up company Organic Initiative Limited.

Bill Veghte

Independent Director since February 2014

Bill has spent 25 years in the IT industry building teams, businesses and technology. He spent 20 years at Microsoft where he served in a variety of engineering and leadership capacities, including running the Windows business and managing Microsoft's North American business. He was the Chief Operating Officer of HP and served as Executive Vice President and General Manager of HP's US\$27 billion Enterprise Group. He was the CEO and director at SurveyMonkey. Bill is currently the Executive Chairman of Turbonomic, a market leader of IT workload automation.

Craig Winkler

Director since May 2009

Craig co-founded Australian small business accounting software provider MYOB in 1991. Craig built MYOB to be a popular business tool and brand which, in 2004, merged with Solution 6 to become Australia's largest IT company. Craig became a substantial shareholder of Xero in 2009, when he also joined the Board. Craig now spends the bulk of his time working in the philanthropic sector.

MANAGEMENT COMMENTARY AND FINANCIAL STATEMENTS

4

THE NUMBERS COUNT

MANAGEMENT COMMENTARY

You should read the following commentary with the consolidated financial statements and the related notes in this report. Some parts of this commentary include information regarding the plans and strategy for the business, and include forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in the following commentary. All amounts are presented in New Zealand dollars (NZD), except where indicated.

Non-GAAP measures have been included, as we believe they provide useful information for readers to assist in understanding Xero's financial performance. Non-GAAP financial measures should not be viewed in isolation nor considered as substitutes for measures reported in accordance with NZ IFRS.

Business results

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Subscription revenue	397,692	289,998	37%
Other operating revenue	8,887	5,391	65%
Total operating revenue	406,579	295,389	38%
Cost of revenue	(76,246)	(69,385)	10%
Gross profit	330,333	226,004	46%
Percentage of operating revenue	81%	77%	4pp*
Total operating expenses	(359,707)	(297,918)	21%
Percentage of operating revenue	88%	101%	-13pp
Other income and foreign exchange	704	1,170	-40%
Operating deficit	(28,670)	(70,744)	-59%
Percentage of operating revenue	-7%	-24%	17pp
Net finance income	1,350	3,674	-63%
Income tax expense	(523)	(1,987)	-74%
Net loss	(27,843)	(69,057)	-60%
Percentage of operating revenue	-7%	-23%	16pp

*pp stands for percentage points

Operating revenue growth was primarily driven by subscriber growth in all markets. Cost of revenue decreased as a proportion of operating revenue, largely driven by the migration to Amazon Web Services (AWS) and productivity gains from investment in the customer service platform. Total operating expenses increased as Xero continued to invest in scaling its global business, new products, and quality subscriber growth. Total operating revenue increased by 38% while operating expenses grew proportionately less at 21% driven by efficiencies and financial discipline, resulting in the operating deficit being 59% lower than the previous year.

Earnings before interest, tax, depreciation, and amortisation (EBITDA)

EBITDA disclosures (which are non-GAAP financial measures) have been included, as we believe they provide useful information for readers to assist in understanding Xero's financial performance. EBITDA is calculated by adding back depreciation, amortisation, net finance income, and income tax expense to net losses.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Net loss	(27,843)	(69,057)	-60%
Add back: net finance income	(1,350)	(3,674)	-63%
Add back: depreciation and amortisation	54,676	42,130	30%
Add back: income tax expense	523	1,987	-74%
EBITDA	26,006	(28,614)	NM*
EBITDA margin	6%	-10%	16pp

*NM stands for not meaningful

EBITDA was positive for the full year for the first time in Xero's history, improving \$54.6 million, compared to the previous year.

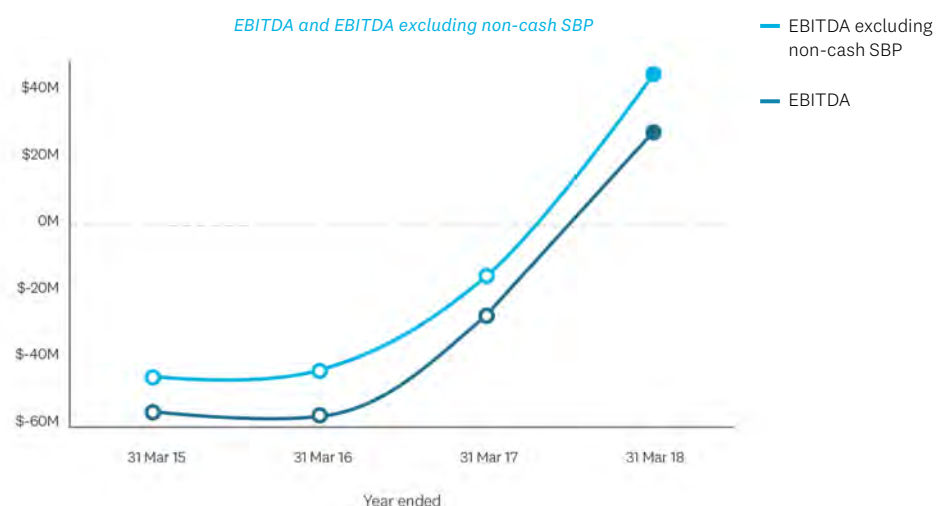
EBITDA has continued to improve on the \$5.4 million from the first half of the year, adding a further \$20.6 million over the second half of the financial year. The improvement was driven by revenue growth as well as operating efficiencies across expense areas.

EBITDA for the year was impacted by write-offs of capitalised software development totalling \$1.5 million, as a result of periodic reviews, as well as \$1.5 million of transaction costs relating to consolidating Xero's listing onto the Australian Securities Exchange (ASX). Additionally product capitalisation rates were lower than the previous year, and share-based payments were \$5.3 million higher than the previous year.

EBITDA excluding the impact of non-cash share-based payments (a non-GAAP financial measure) is also provided as we believe it provides useful information to analyse trends in cash-based expenses.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
EBITDA	26,006	(28,614)	NM
Add back: non-cash share-based payments	17,004	11,723	45%
EBITDA excluding non-cash share-based payments	43,010	(16,891)	NM
Percentage of operating revenue	11%	-6%	17pp

EBITDA excluding non-cash share-based payments (SBP) improved by \$59.9 million over the comparative year.



Operating revenue

Subscription revenue comprises recurring monthly fees from subscribers to Xero's online software. Within a subscription, customers also receive support services and product updates.

Operating revenue also includes revenue from other related services, including attendance fees for conferences and events such as Xerocon, revenue share agreements with other financial web service providers, and the implementation of online accounting software services. Subscription revenue comprises around 98% of operating revenue.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change	change in constant currency
Subscription revenue	397,692	289,998	37%	36%
Other operating revenue	8,887	5,391	65%	56%
Total operating revenue	406,579	295,389	38%	37%

The 37% increase in subscription revenue during the year was primarily driven by year-on-year subscriber growth of 34%, adding 351,000 subscribers in the year.

Other operating revenue increased by 65%, driven by increases in both conference and financial web income. Conference income increased as a result of holding one additional Xerocon during the year compared to the previous year, as well as an increase in the number of attendees and exhibitors that attended Xerocons. Financial web income has increased year-on-year as financial web partnerships are monetised, opening new revenue streams.

Constant currency operating revenue (a non-GAAP financial measure) is provided to assist readers in understanding and assessing Xero's financial performance during the year, excluding the impact of foreign currency fluctuations. Constant currency operating revenue is calculated by translating operating revenue for the 12 months ended 31 March 2018 at the effective exchange rates for the 12 months ended 31 March 2017.

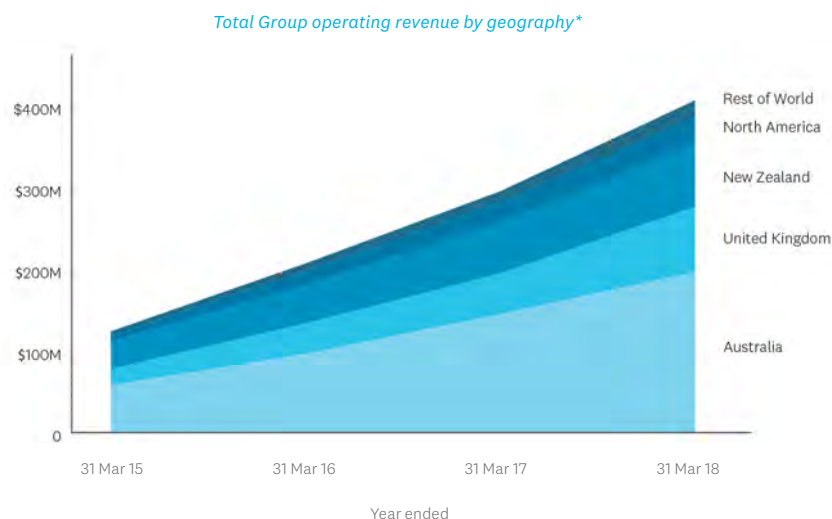
As 81% of Xero's operating revenue is denominated in foreign currencies, the comparatively weaker NZD against Great British pound (GBP) and Australian dollar (AUD) during the year had a positive impact on reported revenue, offset in part by stronger average NZD against the United States dollar (USD). Constant currency operating revenue for the Group in the year was \$3.4 million lower than reported operating revenue. Year-on-year constant currency operating revenue growth was lower than reported revenue growth at 37%.

Operating revenue by geography

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change	change in constant currency
Australia	197,094	145,496	35%	33%
New Zealand	78,807	62,289	27%	27%
Australia and New Zealand (ANZ) total	275,901	207,785	33%	31%
United Kingdom	79,611	49,712	60%	58%
North America	31,793	24,817	28%	29%
Rest of World	19,274	13,075	47%	48%
International total	130,678	87,604	49%	49%
Total operating revenue	406,579	295,389	38%	37%

Operating revenue grew in all of Xero's geographies, with growth of 33% in the established ANZ markets largely due to the increased subscriber base with the two countries accounting for 64% of subscribers at 31 March 2018. Constant currency operating revenue growth for the ANZ markets was lower at 31% with a weaker average NZD against AUD compared to the previous year.

Revenue growth rates in the North America and Rest of World markets were adversely impacted by movements in foreign exchange. However this was more than offset by the strengthening GBP. International markets continue to exhibit strong growth, particularly the UK market growing at 60% and surpassing New Zealand as Xero's second largest market behind Australia.



**represents each region's contribution to total Group operating revenue for the respective period*

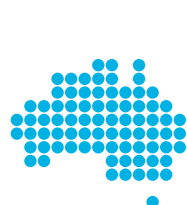
Subscriber numbers

'Subscriber' means each unique subscription to a Xero-offered product that is purchased by an accounting partner or an end user and which is, or is available to be, deployed.

At 31 March	2018	2017	change
Australia	583,000	446,000	31%
New Zealand	301,000	246,000	22%
Australia and New Zealand (ANZ) total	884,000	692,000	28%
United Kingdom	312,000	212,000	47%
North America	132,000	92,000	43%
Rest of World	58,000	39,000	49%
International total	502,000	343,000	46%
Total subscribers	1,386,000	1,035,000	34%

Subscribers grew by 351,000 during the year, or 34%, bringing total subscribers to 1,386,000 at 31 March 2018. ANZ grew by 192,000 subscribers or 28% in the year, demonstrating strength even in Xero's established markets. International subscribers grew at a higher rate, increasing by 159,000 or 46% in the year compared to the 124,000 subscribers added in the previous year.

Regional subscribers at 31 March 2018*



Australia

583,000

2017 // 446,000



United Kingdom

312,000

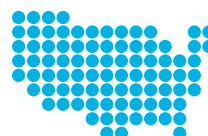
2017 // 212,000



New Zealand

301,000

2017 // 246,000



North America

132,000

2017 // 92,000

*Rest of World subscribers of 58,000 at 31 March 2018 (39,000 at 31 March 2017)

Annualised monthly recurring revenue

With Xero's evolution towards a global small business platform, the recurring revenue metric has been expanded to include other recurring platform revenues including transactional services, and ancillary partner and small business products. Annualised monthly recurring revenue (AMRR) (a non-GAAP financial measure) represents monthly recurring revenue at 31 March, multiplied by 12. It provides a 12 month forward view of revenue, assuming any promotions have ended and other factors such as subscriber numbers, transaction volumes, pricing, and foreign exchange remain unchanged during the year.

AMRR replaces the metric Xero has historically reported - annualised committed monthly revenue (ACMR). ACMR included recurring revenue resulting from a subscriber's subscription. AMRR also includes other revenue streams related to subscriber activity but not necessarily linked to a Xero subscription. Other SaaS metrics including average revenue per user (ARPU), customer acquisition cost (CAC) months, lifetime value (LTV), and churn are now calculated using AMRR. Comparative metrics have been restated for consistency.

Constant currency AMRR (also a non-GAAP financial measure) is calculated by translating AMRR at 31 March 2018 at the foreign exchange rates at 31 March 2017, and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 31 March	2018 (\$000s)	2017 (\$000s)	change	change in constant currency
ANZ	314,496	247,463	27%	30%
International	169,925	115,657	47%	42%
Total	484,421	363,120	33%	33%

The growth in AMRR was driven by subscriber growth, which was supplemented by increases in revenue from platform (non-accounting) services, such as financial web revenue, that grew at a faster rate than core accounting revenue. Xero added \$121.3 million of AMRR in the year ended 31 March 2018, 18% more than the \$103.0 million added in the year ended 31 March 2017.

The weaker NZD against GBP at 31 March 2018 compared to 31 March 2017 was offset by the NZD being stronger against both AUD and USD. The net result is that constant currency AMRR growth is consistent with actual growth at 33%.

Gross profit

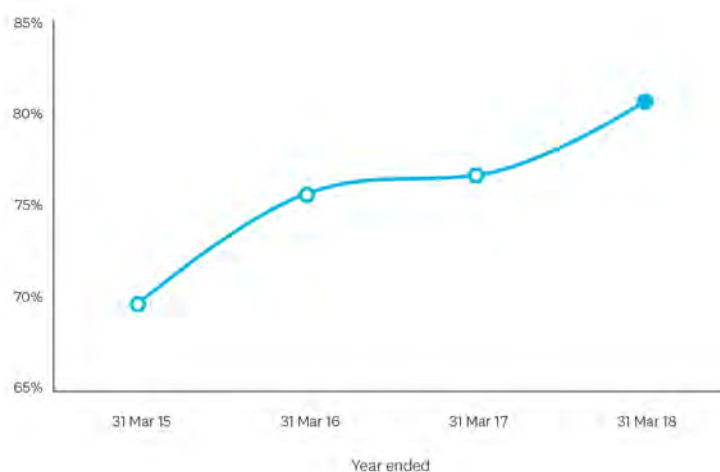
Gross profit represents operating revenue less cost of revenue. Cost of revenue consists of expenses directly associated with securely hosting Xero's services, sourcing relevant data from financial institutions, and providing support to subscribers. The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and amortisation, and allocated overheads.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Operating revenue	406,579	295,389	38%
Cost of revenue	(76,246)	(69,385)	10%
Gross profit	330,333	226,004	46%
Gross margin percentage	81%	77%	4pp

Cost of revenue for the year ended 31 March 2018 grew by \$6.9 million, or 10%, to \$76.2 million. The primary reason for the change was increases in personnel costs related to higher headcount in Xero's customer support teams required to support more subscribers. The higher personnel costs are partially offset by lower hosting costs, with efficiencies from the migration to the AWS platform, and the comparative period including significant costs to operate dual platforms. Operating revenue growth of 38% resulted in gross profit increasing by \$104.3 million, or 46%, to \$330.3 million.

Cost of revenue decreased as a percentage of operating revenue compared with the same period last year due to efficiencies and savings in hosting costs noted above, efficiencies in the customer support teams, and reductions in bank feed costs per subscriber. Gross margin for the year of 81% is an improvement of four percentage points compared to the year ended 31 March 2017.

Gross margin percentage



Sales and marketing

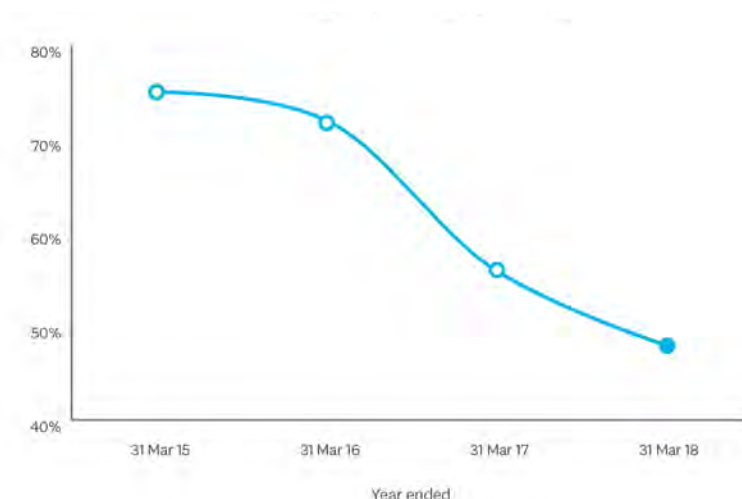
Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, commissions and share-based payments) directly associated with the sales and marketing teams and the cost of educating and onboarding both partners and small business customers. Other costs included are external advertising costs marketing costs and promotional events, as well as allocated overheads.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Sales and marketing expenses	193,909	166,776	16%
Percentage of operating revenue	48%	56%	-8pp

Sales and marketing costs increased by \$27.1 million or 16% to \$193.9 million in the year ended 31 March 2018, compared to operating revenue growth of 38% and subscriber growth of 34%. The majority of sales and marketing costs are incurred in acquiring new subscribers and are expensed in the period, in contrast to the associated revenue from those subscribers which is recognised over the life of the subscriber (currently around seven and a half years on average). The majority of the increase in absolute sales and marketing costs was incurred in the International markets, while costs in the ANZ markets increased at a lower rate. The average cost of acquiring each subscriber has remained stable in the year ending 31 March 2018 at \$377 per gross subscriber added compared to \$371 in the previous year.

As a percentage of operating revenue, sales and marketing costs decreased from 56% to 48% in the year ended 31 March 2018 compared to the year ended 31 March 2017. This is due to efficiencies in decision-making and channel development to achieve more targeted, disciplined and effective sales and marketing expenditure, including efficiencies from growing Xero's global network of accountants and bookkeepers.

Sales and marketing as a percentage of operating revenue



Product design and development

Product design and development costs consist primarily of personnel and related expenses (including salaries, benefits, bonuses and share-based payments) directly associated with product design and development employees, as well as allocated overheads.

The proportion of product design and development expenses that creates a benefit in future years is capitalisable as an intangible asset and is then amortised to the Income Statement over the estimated life of the asset created. The amount amortised relating to the Xero product and platform is included as a product design and development expense.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Total product design and development costs (including amounts capitalised)	143,055	120,204	19%
Percentage of operating revenue	35%	41%	-6pp
Less capitalised development costs	(59,374)	(52,906)	12%
Product design and development expenses (excluding amortisation of amounts capitalised)	83,681	67,298	24%
Less government grants	(4,517)	(3,050)	48%
Add amortisation of capitalised development costs	39,683	29,017	37%
Product design and development expense	118,847	93,265	27%
Percentage of operating revenue	29%	32%	-3pp

Xero continues to invest in its global product and platform, developing a significant range of new features in the year, including:

- Xero HQ Open Practice Platform, an integrated multi-vendor platform for accountants and bookkeepers to run their entire back office
- Xero HQ Ask, driving meaningful engagement between advisors and clients
- Xero Expenses, mobile-first expense management with Open APIs for banks to connect to the millions of employees in small business
- Xero Projects, time and job costing for small businesses in professional services
- Xero Discuss, allows users and their advisors to communicate within the Xero platform
- Xero Lifelong Learning Platform, an online learning tool aimed at students and the reskilling of the workforce, which will be delivered by educational institutions
- Construction Industry Scheme, functionality that allows the UK construction industry to automate tax deductions and filings

Total product design and development costs were \$143.1 million in the year ended 31 March 2018, \$22.9 million higher than the year ended 31 March 2017. Of this, \$59.4 million was capitalised, with the balance of \$83.7 million included as an expense in the Income Statement.

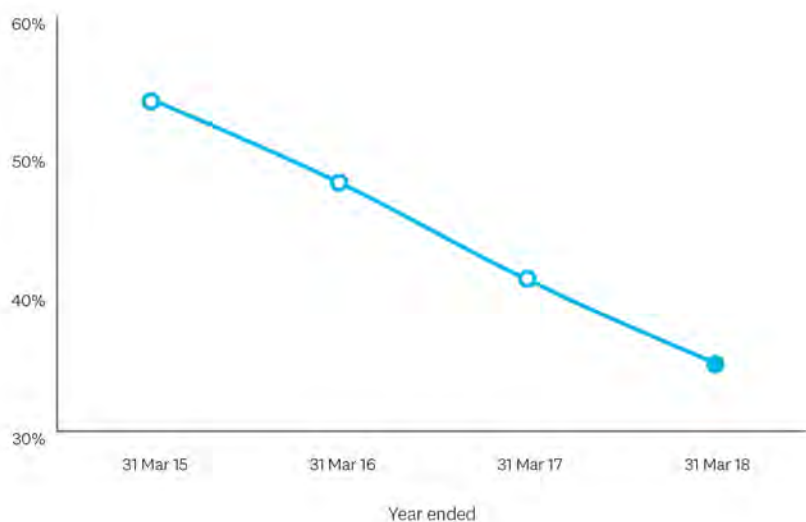
The amount capitalised represents a capitalisation rate of 42% of total product design and development costs for the period, which is two percentage points lower than the year ended 31 March 2017.

The amortisation of capitalised product design and development expenditure of \$39.7 million was included as an expense in the Income Statement giving a total net expense (after government grants) for the period of \$118.8 million. Non-cash amortisation of previously capitalised development costs also increased due to higher intangibles balances than in the previous period.

As a proportion of operating revenue, total product design and development costs including amounts capitalised decreased six percentage points to 35% in the year ended 31 March 2018 from 41% for the same period last year, as costs increased at a slower rate than revenue.

As a proportion of operating revenue, product design and development expenses decreased to 29% in the year ended 31 March 2018 from 32% in the same period last year.

Total product design and development (including amounts capitalised) as a percentage of operating revenue



General and administration

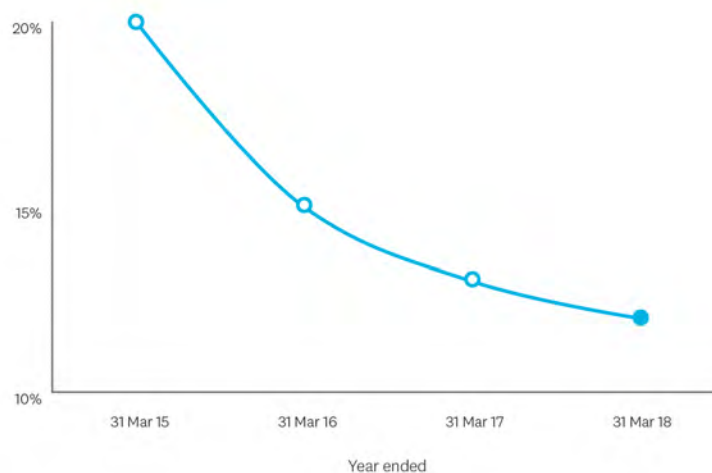
General and administration expenses consist of personnel and related expenses (including salaries, benefits, bonuses, and share-based payments) for executive, finance, billing, legal, human resources, and administrative employees. It also includes legal, accounting, and other professional services fees, insurance premiums, other corporate expenses and allocated overheads.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
General and administration expenses	46,951	37,877	24%
Percentage of operating revenue	12%	13%	-1pp

General and administration costs were \$47.0 million for the year ended 31 March 2018, \$9.1 million or 24% higher than in the year ended 31 March 2017. The increase was primarily due to increased personnel-related costs as a result of headcount growth to support Xero's growth globally, as well as increased merchant fees. The year ended 31 March 2018 also included \$1.5 million of costs incurred to consolidate Xero's listing onto the ASX.

General and administration costs decreased as a proportion of operating revenue from 13% in the year ended 31 March 2017 to 12% in the year ended 31 March 2018 as economies of scale continue to be realised.

General and administration as a percentage of operating revenue



Employees

<i>At 31 March</i>	2018	2017	change
Total Group	2,021	1,721	17%

Full-time equivalent (FTE) employees increased by 300 or 17% in the year ended 31 March 2018 taking the total FTEs to 2,021, compared to a 34% increase in subscribers and 38% increase in operating revenue. The slower growth compared to revenue and subscribers reflects the benefits of economies of scale and operating efficiencies.

Other income and foreign exchange

<i>Year ended 31 March</i>	2018 (\$000s)	2017 (\$000s)	change
Other income and foreign exchange			
Sublease income	1,427	1,128	27%
Foreign exchange gains/(losses)	(723)	42	NM
Total other income and foreign exchange	704	1,170	-40%

Other income includes income from the rental of surplus office space and increased by \$0.3 million in the year impacted by a new sublease being entered into following the move to a new headquarters in Wellington.

Net finance income

<i>Year ended 31 March</i>	2018 (\$000s)	2017 (\$000s)	change
Interest income	2,440	3,781	-35%
Interest expense	(315)	(107)	194%
Bank facility costs	(775)	-	NM
Net finance income	1,350	3,674	-63%

Interest income in the year ended 31 March 2018 was \$2.4 million, a decrease of \$1.3 million or 35% from the year ended 31 March 2017. The decline is due to lower cash and short-term deposit balances as well as lower effective interest rates in the year ended 31 March 2018.

Cash flows

Net movement in cash excluding movement in short-term deposits is a non-GAAP financial measure that has been included to show users net usage of cash and short-term deposits in the period. Xero manages cash and short-term deposits as a portfolio to ensure adequate liquidity is always maintained while preserving capital.

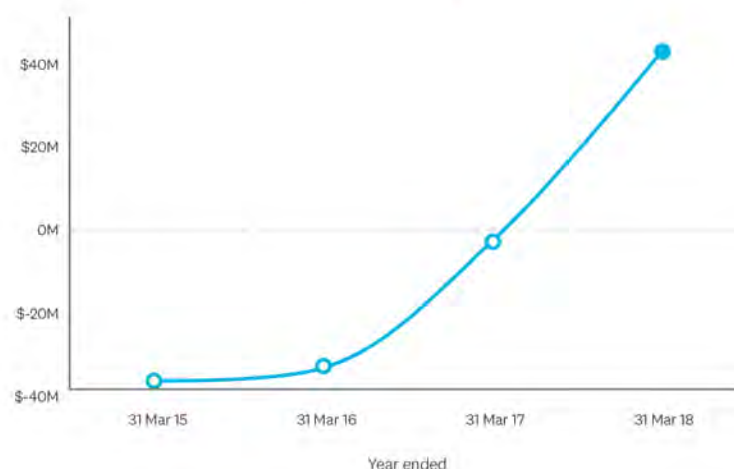
Year ended 31 March	2018 (\$000s)	2017 (\$000s)	change
Receipts from customers	410,470	288,448	42%
Other operating cash flows	(369,319)	(292,849)	26%
Total cash flows from operating activities	41,151	(4,401)	NM
Investing activities	(78,096)	(66,430)	18%
Total operating and investing cash flows	(36,945)	(70,831)	-48%
Financing activities, excluding short-term deposits	3,079	1,057	191%
Currency revaluation	122	(551)	NM
Net movement in cash, excluding movement in short-term deposits	(33,744)	(70,325)	-52%

Receipts from customers increased by 42% or \$122.0 million to \$410.5 million. This was ahead of operating revenue growth largely due to improved payment terms on revenues. Other operating cash outflows increased by 26% or \$76.5 million to \$369.3 million. Net cash flows from operating activities improved by \$45.6 million with receipts from customers 11% greater than operating cash outflows during the year and, notably, 19% greater during the second half of the year.

Investing activities increased by 18% or \$11.7 million largely due to capital expenditure relating to Xero's new headquarters in Wellington, New Zealand, and higher capitalised software development costs. Total operating and investing cash outflows decreased by 48% from the year ended 31 March 2017, due to increases in receipts from customers and increased discipline across operating and capital expenditure.

Net movement in cash, excluding movements in short-term deposits of \$33.7 million, has improved by \$36.6 million, or 52%, when compared to the same period last year.

Cash flows from operating activities



Segment information

Operating revenue is allocated to a segment depending on where the subscriber resides. Segment expenses include cost of revenue, sales and marketing costs incurred directly in-region, and an allocation of centrally managed costs and overheads, such as hosting and subscriber support costs.

	ANZ (\$000s)	International (\$000s)	Total (\$000s)
<i>Year ended 31 March 2018</i>			
Operating revenue	275,901	130,678	406,579
Expenses	(120,236)	(149,919)	(270,155)
Other income	356	1,071	1,427
Segment contribution	156,021	(18,170)	137,851
<i>Contribution margin percentage</i>	57%	-14%	34%
	ANZ (\$000s)	International (\$000s)	Total (\$000s)
<i>Year ended 31 March 2017</i>			
Operating revenue	207,785	87,604	295,389
Expenses	(113,199)	(122,962)	(236,161)
Other income	–	1,128	1,128
Segment contribution	94,586	(34,230)	60,356
<i>Contribution margin percentage</i>	46%	-39%	20%

ANZ – Operating revenue for the year ended 31 March 2018 grew by 33% compared to the year ended 31 March 2017, slightly ahead of subscriber growth of 28% which is largely due to the comparatively weaker NZD against the AUD. This, along with cost efficiencies, resulted in the segment contribution for the year improving as a percentage of operating revenue from 46% to 57%. The improvement was driven by performance in both Australia and New Zealand. Australia added 137,000 subscribers in the year ended 31 March 2018 to finish with 583,000 paying subscribers, and operating revenue of \$197.1 million for the year, a 35% improvement on the year ended 31 March 2017.

International – Operating revenue grew by 49% due in the most part to subscriber growth of 46% as well as the UK hosting a Xerocon in the year ended 31 March 2018. The contribution margin improved significantly, from -39% to -14%, due to efficiencies and channel development, in particular in the United Kingdom and North America, while maintaining strong revenue growth. The contribution margin was comparatively lower than that of ANZ, reflective of the investment to accelerate growth in the United Kingdom, North America, and Asia as Xero continues to build brand recognition and distribution channels in its emerging markets. International's contribution loss slowed to \$18.2 million in the year ended 31 March 2018 as compared to \$34.2 million in the year ended 31 March 2017.

KEY SAAS METRICS

Average revenue per user (ARPU) is calculated as AMRR (see the definition on page 31) at 31 March divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months or months of ARPU to recover CAC (cost of acquiring subscribers) represent the number of months of revenue required to recover the cost of acquiring each new subscriber. The calculation is sales and marketing costs for the year less conference revenue (such as Xerocon) divided by gross new subscribers added during the same period, divided by ARPU.

MRR churn is the value of monthly recurring revenue (MRR) from subscribers who leave Xero in a month as a percentage of the total MRR at the start of that month. The percentage provided is the average of the monthly churn for the previous 12 months.

Lifetime value (LTV) is the gross margin expected from a subscriber over the lifetime of that subscriber. This is calculated by taking the average subscriber lifetime (one divided by MRR churn) multiplied by ARPU multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTVs, multiplied by their respective segment subscribers, divided by total Group subscribers.

LTV/CAC is the ratio between the LTV and the cost to acquire that subscriber, e.g. the lifetime gross margin derived from a subscriber in ANZ is currently on average 11.4 times the cost of acquiring that subscriber.

The table below outlines key metrics across Xero's segments:

<i>At 31 March 2018</i>	ANZ	International	Total
ARPU (\$)	29.6	28.2	29.1
CAC months	8.4	18.7	13.0
MRR churn	0.86%	1.62%	1.10%
LTV per subscriber (\$)	2,829	1,397	2,310
LTV/CAC	11.4	2.6	6.1

<i>At 31 March 2017¹</i>	ANZ	International	Total
ARPU (\$)	29.8	28.1	29.2
CAC months	8.1	20.0	12.8
MRR churn	0.88%	1.77%	1.15%
LTV per subscriber (\$)	2,591	1,222	2,137
LTV/CAC	10.8	2.2	5.7

1. SAAS metrics for the comparative period have been restated as a result of the change from ACMR to AMRR

ANZ – ARPU decreased by less than 1%, due to the comparatively stronger NZD against the AUD at 31 March 2018 compared to 31 March 2017. In constant currency terms, ARPU increased by over 1% in the year to 31 March 2018 driven by the product mix in both Australia and New Zealand. Improved segment gross margin with low MRR churn led to a 9% improvement in LTV per subscriber. Total LTV increased by 39% to \$2.5 billion at 31 March 2018. CAC months at 31 March 2018 was slightly higher when compared to the same period last year as Xero continues to invest in the mature Australian and New Zealand markets. As a result of the increase in LTV, LTV/CAC at 31 March 2018 increased 6% to 11.4 times.

International – Most key metrics across the International segment improved over the year. ARPU increased by less than 1%, due to the comparatively weaker NZD against the GBP at 31 March 2018 compared to 31 March 2017. In constant currency terms, ARPU decreased by 3% over the year to 31 March 2018 largely driven by channel shift towards the partner channel, particularly in North America. Improved MRR churn and segment gross margin led to a 14% higher LTV at 31 March 2018 compared to the same time last year. In constant currency terms, LTV per subscriber was 10% higher than at 31 March 2017. Total LTV for the international segment increased by 67% to \$701 million at 31 March 2018. CAC months at 31 March 2018 improved by 7% as compared to the same time last year. As a result of improvements across most metrics, LTV/CAC at 31 March 2018 was 2.6 times, an 18% increase on 31 March 2017.

Total Group – ARPU decreased by less than 0.5% in both actual and constant currency, due to product mix in ANZ being offset by a shift towards the more efficient but lower ARPU partner channel, particularly in the International markets. LTV increased 8% to \$2,310 per subscriber, due to the improvements in churn and gross margin. Group constant currency LTV per subscriber at 31 March 2018 was 9% higher than at 31 March 2017. Total LTV at 31 March 2018 was \$3.2 billion, which is a \$1.0 billion improvement compared to 31 March 2017. CAC months increased 2% to 13.0 months when compared to 31 March 2017 due to continued investment in the ANZ markets. As a result of the improvement across most metrics, LTV/CAC increased 7% to 6.1 times.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF XERO LIMITED



OPINION

We have audited the financial statements of Xero Limited (“the company”) and its subsidiaries (together “the Group”) on pages 43 to 68, which comprise the consolidated statement of financial position of the group as at 31 March 2018, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended of the group, and the notes to the consolidated financial statements including a summary of significant accounting policies.

In our opinion, the consolidated financial statements on pages 43 to 68 present fairly, in all material respects, the consolidated financial position of the group as at 31 March 2018 and its consolidated financial performance and cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

This report is made solely to the company's shareholders, as a body. Our audit has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's shareholders, as a body, for our audit work, for this report, or for the opinions we have formed.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (New Zealand). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

We are independent of the group in accordance with Professional and Ethical Standard 1 (revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Ernst & Young has provided remuneration market data, Australian research and development tax credit related compliance services, a Type II independent assurance report on Xero's technology controls in accordance with ISAE 3402, a Cloud Controls Matrix (CCM) Gap Assessment and other assurance services relating to the Callaghan grant. We have no other relationship with, or interest in, Xero Limited or any of its subsidiaries. Partners and employees of our firm may deal with the group on normal terms within the ordinary course of trading activities of the business of the group.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the financial statements section of the audit report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

1. Capitalised Development Costs

WHY SIGNIFICANT

The Group capitalises costs incurred in the development of its software. These costs are then amortised over the estimated useful life of the software.

The Group's process for calculating the value of internally developed software involves judgment as it includes estimating time which staff spend developing software and determining the value attributable to that time. The Group's capitalised costs are disclosed in Note 11 to the financial statements.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

Our work on capitalised development costs focused on the Group's process for estimating the time spent by staff on software development that can be capitalised under NZ IAS 38. Our audit procedures included the following:

- Assessed the nature of a sample of projects against the requirements of NZ IAS 38 to determine if they were capital in nature;
- Assessed the review procedures applied by the Group to review the rates applied to capitalise payroll costs;
- Assessed the effectiveness of controls over the payroll process;
- Assessed capitalised costs with reference to actual payroll information for a sample of employees; and
- Assessed the adequacy of the disclosures related to capitalised development costs in the consolidated financial statements.

2. Impairment of capitalised development costs

WHY SIGNIFICANT

Intangible assets make up 85% of the Group's non-current assets. The most significant of these intangibles is capitalised software development costs.

NZ IAS 36 Impairment of Assets requires that finite life intangible assets be tested for impairment whenever there is an indication that the intangible assets may be impaired and this assessment requires judgment.

Disclosures relating to Intangible Assets, including key assumptions, are disclosed in Note 11 to the consolidated financial statements.

The assessment as to whether there are any indicators of impairment requires judgment including consideration of both internal and external sources of information.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

We assessed the factors that the Group considered regarding impairment of capitalised development costs and whether any indicators of impairment existed. This included having regard to:

- Significant changes in the extent or manner in which the associated software is used;
- Potential or actual redundancy or disposal of developed software;
- Forecast cash flows associated to the capitalised development costs;
- Amortisation periods applied by the Group to developed software relative to its experience of software lifecycle;
- Significant changes in the market in which the assets are used; and
- We assessed the adequacy of the disclosures related to impairment considerations in the consolidated financial statements.

INFORMATION OTHER THAN THE FINANCIAL STATEMENTS AND AUDITOR'S REPORT

The directors of the company are responsible for the Annual Report, which includes information other than the consolidated financial statements and auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

If, based upon the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The directors are responsible, on behalf of the entity, for the preparation and fair presentation of the consolidated financial statements in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

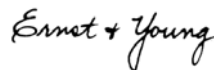
In preparing the consolidated financial statements, the directors are responsible for assessing on behalf of the entity the group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or cease operations, or have no realistic alternative but to do so.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located at the External Reporting Board's website: <https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/>. This description forms part of our auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Grant Taylor.



Chartered Accountants
Wellington

10 May 2018

FINANCIAL STATEMENTS

Income Statement

		Year ended 31 March	
	Notes	2018 (\$000s)	2017 (\$000s)
Subscription revenue		397,692	289,998
Other operating revenue		8,887	5,391
Total operating revenue	4	406,579	295,389
Cost of revenue	6	(76,246)	(69,385)
Gross profit		330,333	226,004
<i>Operating expenses</i>			
Sales and marketing		(193,909)	(166,776)
Product design and development		(118,847)	(93,265)
General and administration		(46,951)	(37,877)
Total operating expenses	6	(359,707)	(297,918)
Foreign exchange (losses)/gains		(723)	42
Other income		1,427	1,128
Operating deficit		(28,670)	(70,744)
Net finance income	5	1,350	3,674
Net loss before tax		(27,320)	(67,070)
Income tax expense	7	(523)	(1,987)
Net loss		(27,843)	(69,057)
<i>Earnings per share</i>			
Basic and diluted loss per share	8	(\$0.20)	(\$0.50)

Statement of Comprehensive Income

		Year ended 31 March	
	Notes	2018 (\$000s)	2017 (\$000s)
Net loss		(27,843)	(69,057)
Other comprehensive income*			
Movement in cash flow hedges	19	3,346	2,029
Income tax effect of cash flow hedges	7	(483)	-
Translation of international subsidiaries		143	(1,414)
Total other comprehensive income for the year		3,006	615
Total comprehensive loss for the year		(24,837)	(68,442)

* Items of other comprehensive income may be reclassified to the Income Statement
The accompanying notes form an integral part of these financial statements

Statement of Financial Position

		At 31 March	
	Notes	2018 (\$'000s)	2017 (\$'000s)
Assets			
<i>Current assets</i>			
Cash and cash equivalents		20,955	27,699
Short-term deposits		59,000	86,000
Trade and other receivables	9	34,523	32,817
Short-term derivative assets	19	2,508	801
Other current assets		993	393
Total current assets		117,979	147,710
<i>Non-current assets</i>			
Property, plant and equipment	10	21,172	15,881
Intangible assets	11	144,781	125,619
Deferred tax assets	7	2,896	2,065
Long-term derivative assets	19	41	17
Bonds and other deposits		2,207	1,958
Total non-current assets		171,097	145,540
Total assets		289,076	293,250
Liabilities			
<i>Current liabilities</i>			
Trade and other payables	12	26,285	32,712
Employee entitlements		27,980	27,336
Current income taxes payable	7	537	1,105
Short-term provisions	14	10	555
Short-term derivative liabilities	19	822	2,397
Other current liabilities	13	5,443	1,551
Total current liabilities		61,077	65,656
<i>Non-current liabilities</i>			
Deferred tax liabilities	7	173	546
Long-term provisions	14	1,741	851
Long-term derivative liabilities	19	–	17
Other long-term liabilities		2,958	2,030
Total non-current liabilities		4,872	3,444
Total liabilities		65,949	69,100
Equity			
Share capital	15	537,744	522,610
Accumulated losses		(334,838)	(306,995)
Reserves		20,221	8,535
Total equity		223,127	224,150
Total liabilities and shareholders' equity		289,076	293,250

The accompanying notes form an integral part of these financial statements

Statement of Changes in Equity

	Notes	Share capital (\$000s)	Treasury shares (\$000s)	Share-based payment reserve (\$000s)	Accumulated losses (\$000s)	Foreign currency translation reserve (\$000s)	Cash flow hedge reserve (\$000s)	Total equity (\$000s)
Balance at 1 April 2017		532,583	(9,973)	10,224	(306,995)	(93)	(1,596)	224,150
Net loss		-	-	-	(27,843)	-	-	(27,843)
Other comprehensive income		-	-	-	-	143	2,863	3,006
Total comprehensive loss		-	-	-	(27,843)	143	2,863	(24,837)
<i>Transactions with owners:</i>								
Share-based payments – employee restricted share plan	21	12,709	(1,879)	922	-	-	-	11,752
Share-based payments – restricted stock units	21	931	-	4,091	-	-	-	5,022
Share-based payments – restricted stock units withheld to pay tax	21	-	-	(121)	-	-	-	(121)
Share-based payments – directors and advisors	21	190	-	632	-	-	-	822
Share-based payments – employee share options	21	-	-	3,993	-	-	-	3,993
Exercising of employee share options	15	3,183	-	(837)	-	-	-	2,346
Balance at 31 March 2018		549,596	(11,852)	18,904	(334,838)	50	1,267	223,127
Balance at 1 April 2016		516,165	(12,819)	15,985	(237,938)	1,321	(3,625)	279,089
Net loss		-	-	-	(69,057)	-	-	(69,057)
Other comprehensive income/(loss)		-	-	-	-	(1,414)	2,029	615
Total comprehensive loss		-	-	-	(69,057)	(1,414)	2,029	(68,442)
<i>Transactions with owners:</i>								
Share-based payments – employee restricted share plan	21	8,749	853	(334)	-	-	-	9,268
Share-based payments – restricted stock units	21	6,178	-	(3,422)	-	-	-	2,756
Share-based payments – restricted stock units withheld to pay tax	21	-	-	(3,026)	-	-	-	(3,026)
Share-based payments – directors and advisors	21	76	-	(753)	-	-	-	(677)
Share-based payments – employee share options	21	-	-	3,547	-	-	-	3,547
Exercising of director share options	15	763	-	(220)	-	-	-	543
Exercising of employee share options	15	652	-	(138)	-	-	-	514
Share-based payments – employee schemes arising on acquisition		-	1,993	(1,415)	-	-	-	578
Balance at 31 March 2017		532,583	(9,973)	10,224	(306,995)	(93)	(1,596)	224,150

The accompanying notes form an integral part of these financial statements

Statement of Cash Flows

	Note	Year ended 31 March	
		2018 (\$'000s)	2017 (\$'000s)
Operating activities			
Receipts from customers		410,470	288,448
Other income		5,497	4,116
Interest received		2,315	4,766
Payments to suppliers and employees		(374,626)	(299,638)
Income tax paid		(2,505)	(2,093)
Net cash flows from operating activities	16	41,151	(4,401)
Investing activities			
Purchase of property, plant and equipment		(15,329)	(6,694)
Sale of property, plant and equipment		1,507	-
Capitalised development costs		(63,767)	(57,976)
Other intangible assets		-	(1,641)
Rental bonds		(507)	(119)
Net cash flows from investing activities		(78,096)	(66,430)
Financing activities			
Exercising of share options		2,346	1,057
Proceeds from borrowings		3,515	-
Repayment of borrowings		(2,782)	-
Payments for short-term deposits		(74,000)	(112,000)
Proceeds from short-term deposits		101,000	171,000
Net cash flows from financing activities		30,079	60,057
Net decrease in cash and cash equivalents		(6,866)	(10,774)
Foreign currency translation adjustment		122	(551)
Cash and cash equivalents at the beginning of the year		27,699	39,024
Cash and cash equivalents at the end of the year		20,955	27,699

The accompanying notes form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

1. REPORTING ENTITY AND STATUTORY BASE

Xero Limited ('the Company') is a company registered under the New Zealand Companies Act 1993 and is listed on the Australian Securities Exchange (ASX). The Company is an FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013. The audited consolidated financial statements of Xero Limited and its subsidiaries (together 'the Group' or 'Xero') have been prepared in accordance with the requirements of Part 7 of the Financial Markets Conduct Act 2013 and the ASX Listing Rules.

On 2 February 2018 the Company delisted from the New Zealand Stock Exchange (NZX) and moved to a sole listing on the ASX effective from 5 February 2018. Before this, the company was listed on the ASX and the Main Board of the NZX.

The consolidated financial statements of the Group for the year ended 31 March 2018 were authorised for issue in accordance with a resolution of the directors on 10 May 2018.

2. BASIS OF ACCOUNTING

(a) Basis of preparation The financial statements of the Group have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). The Group is a for-profit entity for the purposes of complying with NZ GAAP. The consolidated financial statements comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and other New Zealand accounting standards and authoritative notices that are applicable to entities that apply NZ IFRS. The consolidated financial statements also comply with International Financial Reporting Standards.

Other than where described below, or in the notes, the consolidated financial statements have been prepared using the historical cost convention.

The consolidated financial statements are presented in New Zealand dollars (\$) (the 'presentation currency'). Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency').

(b) Changes in accounting policies and disclosures The accounting policies and disclosures adopted are consistent with those of the previous year.

Certain comparative information has also been reclassified to conform with the current period's presentation.

(c) Standards or interpretations issued but not yet effective and relevant to the Group

The International Accounting Standards Board has issued a number of standards, amendments and interpretations which are not yet effective and which may have an impact on the Group's financial statements. These are detailed below. The Group has not yet applied these in preparing these financial statements.

- **(a) NZ IFRS 9: Financial Instruments.** This standard replaces NZ IAS 39: *Financial Instruments: Recognition and Measurement* and addresses the classification, measurement and recognition of financial assets, financial liabilities, impairment of financial assets and hedge accounting. NZ IFRS 9 is effective for the year ended 31 March 2019.

The standard introduces an 'expected credit loss model' which means it will no longer be necessary for a triggering event to occur before an impairment loss is recognised. The Group will be required to assess for impairment loss on trade receivables at the time revenue is recognised. Currently an impairment loss is recognised when trade receivables are past due. Management has performed an initial assessment of the impact of NZ IFRS 9 on the measurement of expected impairment losses on adoption. While this will likely result in an increase in the Group's provision for doubtful debts, it is not expected to be material. The cumulative impact of the change will be adjusted through opening retained earnings.

Hedge accounting under NZ IFRS 9 will require hedge accounting relationships to align specifically with Xero's risk management objectives and strategy and includes a more qualitative and forward-looking approach to assessing hedge effectiveness. The Group expects that the existing hedge accounting relationships will continue to qualify under NZ IFRS 9.

- **(b) NZ IFRS 15: Revenue from Contracts with Customers.** This standard replaces NZ IAS 18: *Revenue* in establishing the framework for revenue recognition and is effective for the year ended 31 March 2019. The standard requires the incremental costs of obtaining a contract to be capitalised and expensed on a systematic basis. Costs of obtaining a contract, such as commission costs, are currently expensed as incurred. The standard also requires revenue to be recognised as distinct performance obligations are satisfied, which could alter the timing and classification of revenue recognition.

Management has performed an initial assessment of the impact of NZ IFRS 15 and does not expect the recognition and measurement of revenue to materially change under the new standard. The majority of Xero's customers are on monthly terms, meaning that most costs associated with obtaining contracts would not need to be spread over a longer term. Xero's bundled offerings typically consist solely of the provision of cloud software along with support services. These services are determined to be performed uniformly over the contractual term, which is generally one month, meaning that the identification of distinct performance obligations have no impact on the timing of revenue recognition.

The impact of deferring incremental costs in obtaining a contract or any revenue which would be deferred resulting from contracts with terms greater than one month is not expected to be material.

- **(c) NZ IFRS: 16 Leases.** This standard replaces NZ IAS 17: *Leases* and changes the way in which the Group accounts for its operating leases. The new standard requires recognition of a lease liability and a right-of-use asset at inception based on the future lease payments for substantially all lease contracts. The expense previously recorded in relation to operating leases will move from being included in operating expenses to within depreciation and finance expense.

NZ IFRS 16 is effective for the year ended 31 March 2020 with early adoption permitted. The Group intends to adopt the standard for the year ended 31 March 2019.

Management has performed an initial assessment of the financial impact on the Group based on leases in effect at 31 March 2018. For the year ended 31 March 2018 we estimate the new standard would have resulted in a \$10.8 million decrease in operating lease expense, \$9.0 million increase in depreciation, and \$2.2 million increase in finance expense. The overall impact on net loss before tax would have been an increase of \$0.4 million. The impact on the statement of financial position as at 31 March 2018 would have been an increase in assets of approximately \$46.4 million, and liabilities of approximately \$52.4 million. These estimates may differ materially to the actual impact on adoption in the year ended 31 March 2019.

(d) Critical accounting estimates In applying the Group's accounting policies, management continually evaluates judgements, estimates, and assumptions based on experience and other factors, including expectations of future events that may have an impact on the Group. All judgements, estimates, and assumptions made are believed to be reasonable based on the most current set of circumstances available to the Group. Actual results may differ from the judgements, estimates and assumptions.

The significant judgements, estimates and assumptions made by management in the preparation of these financial statements are outlined below.

Deferred tax assets The Group recognises a deferred tax asset in relation to tax losses, only to the extent of the Group's deferred tax liabilities. The Group has not recognised a deferred tax asset in respect of additional losses and other temporary differences given the uncertainty of the timing of profitability and the requirement for ownership continuity. Deferred tax assets and deferred tax liabilities are recognised in the subsidiaries in respect of temporary differences. Deferred tax assets are only recognised in the subsidiaries to the extent that it is probable the assets will be utilised.

Capitalised development costs The Group capitalises a proportion of costs (including employee costs) related to software development. The Group regularly reviews the carrying value of capitalised development costs to ensure they are not impaired. The development costs are amortised over three to five years, with limited exceptions to this for assets specifically identified as having shorter useful lives.

At 31 March 2018, if capitalisation rates had been 10% higher/lower with all other variables held constant, the impact on operating expenses would have been \$9.9 million lower/higher.

3. SEGMENT INFORMATION

The Group operates in one business segment, providing online solutions for small businesses and their advisors.

Xero has two operating segments: Australia and New Zealand (ANZ); and International. These segments have been determined based on the way the Global Executive team (the chief operating decision-maker) reviews financial performance.

Segment operating expenses represent sales and marketing costs and service delivery costs, including both in-country costs and an allocation of centrally managed costs.

	ANZ (\$000s)	International (\$000s)	Total (\$000s)
Year ended 31 March 2018			
Operating revenue	275,901	130,678	406,579
Expenses	(120,236)	(149,919)	(270,155)
Other income	356	1,071	1,427
Segment contribution	156,021	(18,170)	137,851
Year ended 31 March 2017			
Operating revenue	207,785	87,604	295,389
Expenses	(113,199)	(122,962)	(236,161)
Other income	–	1,128	1,128
Segment contribution	94,586	(34,230)	60,356

Reconciliation from segment contribution to net loss before income tax

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Segment contribution	137,851	60,356
Product design and development	(118,847)	(93,265)
General and administration	(46,951)	(37,877)
Foreign exchange gains/(losses)	(723)	42
Net finance income	1,350	3,674
Net loss before tax	(27,320)	(67,070)

At 31 March 2018, \$157.5 million, or 98%, of the Group's property, plant and equipment and intangible assets was domiciled in New Zealand (2017: \$133.5 million, or 95%).

Depreciation and amortisation by segment

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
ANZ	3,460	2,954
International	5,310	4,045
Corporate (not allocated to a segment)	45,906	35,131
Total	54,676	42,130

Employee entitlements: share-based payments by segment

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
ANZ	3,577	3,349
International	5,858	2,655
Corporate (not allocated to a segment)	6,530	4,542
Total	15,965	10,546

4. REVENUE

Subscription revenue

Subscription revenue comprises the recurring monthly fees from subscribers to Xero's online accounting software services. Subscribers are invoiced monthly. Revenue is recognised, as the services are provided to the subscribers. Unbilled revenue at year end is recognised in the Statement of Financial Position as accrued income and included within trade and other receivables. Unearned revenue at year end is recognised in the Statement of Financial Position as income in advance and included within other current liabilities.

Other operating revenue

Other operating revenue comprises revenue from related services such as education and the implementation of the online accounting software services, along with conference income and financial web income. Revenue is recognised as the services are provided to the customers.

Revenue by geographic location

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Australia	197,094	145,496
New Zealand	78,807	62,289
United Kingdom	79,611	49,712
North America	31,793	24,817
Rest of World	19,274	13,075
Total	406,579	295,389

5. NET FINANCE INCOME

Net finance income includes interest income and expense as well as costs associated with bank facilities. Interest income is recognised as it is accrued using the effective interest method. The effective interest method calculates the amortised cost of the financial asset and allocates the interest income over its expected life.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Interest income – cash and short-term deposits	2,440	3,781
Interest expense	(315)	(107)
Bank facility costs	(775)	–
Total net finance income	1,350	3,674

6. EXPENSES

Overhead allocation

The presentation of the Income Statement by function requires certain overhead costs to be allocated to functions. These allocations require management to apply judgement. Facilities, internal information technology costs, and depreciation and amortisation not relating to product software development have been allocated to each function on a headcount basis. Recruitment costs have been allocated according to the number of employees hired in each function during the period. The amortisation of product-related software development is included in product design and development.

Sales tax

The Income Statement and the Statement of Cash Flows have been prepared so that all components are stated exclusive of sales tax, except where sales tax is not recoverable. All items in the Statement of Financial Position are stated net of sales tax with the exception of receivables and payables, which include sales tax invoiced. Sales tax includes Goods and Services Tax and Value Added Tax where applicable.

Cost of revenue and operating expenses

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Employee entitlements	228,621	188,937
Employee entitlements – share-based payments	27,291	22,860
Employee entitlements capitalised	(58,234)	(50,975)
Advertising and marketing	61,122	59,838
Platform costs	30,068	31,821
Consulting and contractors	14,804	11,518
Computer equipment and software	13,815	7,302
Rental costs	13,545	11,224
Travel-related costs	9,245	7,146
Superannuation costs	8,188	6,867
Communication, insurance and office administration	5,051	5,056
Staff recruitment	2,340	2,012
Directors' fees	926	486
Auditors remuneration	417	355
Other operating expenses	24,078	20,726
Total cost of revenue and operating expenses excl. depreciation and amortisation *	381,277	325,173

*Includes grant income of \$4.5 million (2017: \$3.1 million)

Depreciation and amortisation

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
<i>Relating to:</i>		
Amortisation of development costs	45,614	33,834
Amortisation of other intangible assets	1,011	1,661
Depreciation of property, plant and equipment	8,051	6,635
Total depreciation and amortisation	54,676	42,130
Total cost of revenue and operating expenses	435,953	367,303
<i>Depreciation and amortisation included in function expenses as follows:</i>		
Product design and development	44,762	34,114
Cost of revenue	5,477	3,123
Sales and marketing	3,293	3,876
General and administration	1,144	1,017
Total depreciation and amortisation	54,676	42,130

Auditors' remuneration

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Audit and review of financial statements	252	236
Taxation services	28	28
Other assurance services *	135	87
Other services **	2	4
Total fees paid to auditors	417	355

* Services relate to assurance services in connection with reporting on service organisation controls, and compliance engagement in respect of grant application

** Services relate to provision of remuneration market data

7. CURRENT AND DEFERRED INCOME TAX

Tax expense comprises current and deferred tax. Income tax is recognised in the Income Statement except when it relates to items recognised directly in other comprehensive income (in which case the income tax is recognised in other comprehensive income). Income tax is based on tax rates and regulation enacted in the jurisdictions in which the entities operate.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is based on the expected manner of realisation of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the end of the reporting period.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Current income tax

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the New Zealand statutory income tax rate as follows:

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Accounting loss before income tax	(27,320)	(67,070)
At the New Zealand statutory income tax rate of 28%	(7,650)	(18,780)
Non-deductible expenditure	1,038	1,570
Prior period adjustment	(23)	(180)
Impact of prior year research and development credit claims	(1,089)	(154)
Utilisation of prior year tax losses not previously recognised	(8,050)	-
Net research and development expense deferred	8,327	-
Tax rate variance of subsidiaries	(2,722)	184
Total tax losses not recognised in current year	10,692	19,347
Income tax expense	523	1,987
<i>Comprising:</i>		
Income tax payable	3,030	2,631
Prior period adjustment	(23)	(180)
Impact of prior year research and development credit claims	(1,089)	(154)
Deferred tax	(938)	(255)
Tax losses utilised	(483)	-
Effect of changes in foreign currency	26	(55)
Income tax expense	523	1,987

Income tax payable

At 31 March	2018 (\$000s)	2017 (\$000s)
Opening balance	1,105	311
Prior period adjustment	(43)	465
Impact of prior period research and development credit claims	(1,089)	(154)
Income tax liability for the year	3,030	2,631
Income tax paid	(2,505)	(2,093)
Effects of changes in foreign currency	39	(55)
Current tax payable	537	1,105

Deferred income tax

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	Derivatives (\$000s)	Provisions and employee benefits (\$000s)	Tax depreciation (\$000s)	Tax losses (\$000s)	Total (\$000s)
Year ended 31 March 2018					
<i>Deferred tax asset balances:</i>					
At 1 April 2017	-	2,879	70	(884)	2,065
Prior period adjustment	-	106	14	-	120
Charged to income statement	-	486	372	(293)	565
Charged to equity	-	413	-	(267)	146
Impact of change in tax rates	-	(518)	187	331	-
At 31 March 2018	-	3,366	643	(1,113)	2,896
<i>Deferred tax liability balances:</i>					
At 1 April 2017	447	2,461	(10,586)	7,132	(546)
Prior period adjustment	-	55	(37)	(18)	-
Charged to income statement	-	1,997	(3,851)	2,040	186
Charged to other comprehensive income	(930)	-	-	447	(483)
Charged to equity	-	349	-	(349)	-
Tax losses utilised	-	-	-	483	483
Impact of change in tax rates	-	-	187	-	187
At 31 March 2018	(483)	4,862	(14,287)	9,735	(173)
Year ended 31 March 2017					
<i>Deferred tax asset balances:</i>					
At 1 April 2016	-	1,689	(313)	-	1,376
Prior period adjustment	-	742	(95)	-	647
Charged to income statement	-	450	479	(884)	45
Foreign currency adjustment	-	(2)	(1)	-	(3)
At 31 March 2017	-	2,879	70	(884)	2,065
<i>Deferred tax liability balances:</i>					
At 1 April 2016	1,015	2,228	(6,992)	2,994	(755)
Prior period adjustment	-	(168)	(6)	173	(1)
Charged to income statement	-	401	(3,588)	3,397	210
Charged to other comprehensive income	(568)	-	-	568	-
At 31 March 2017	447	2,461	(10,586)	7,132	(546)

Recognised temporary differences

The Group's recognised deferred tax asset and deferred tax liability are expected to be recovered by \$1.8 million and \$0.1 million respectively within the next 12 months. Deferred tax assets and liabilities have been offset where the balances are due to/receivable from the same counterparties. Deferred income tax assets are recognised for carried forward tax losses to the extent of deferred tax liabilities.

Unrecognised temporary differences

The Group has elected to defer the deduction of research and development expenditure in accordance with DB 34(7) and EE 1(5) of the Income Tax Act 2007. During the year, the Group elected to defer the deduction of \$32.0 million of research and development expenditure incurred during the year ended 31 March 2018, and \$25.0 million of research and development expenditure incurred during the year ended 31 March 2017.

The total amount of deferred research and development expenditure available to the group is \$54.7 million (2017: nil), after accounting for deferred research and development expenditure recognised in the 2018 financial year of \$2.3 million. The deferred research and development expenditure can be deducted from taxable income in future periods, and the ability to carry forward deferred research and development expenditure is not dependent on maintaining shareholder continuity.

The Group has estimated unrecognised tax losses available to carry forward of \$312.2 million (2017: \$325.7 million) subject to shareholder continuity being maintained.

In addition, the Group has unrecognised non-refundable research and development tax credits in the United States of USD \$1.2 million (2017: nil), which can be carried forward for 20 years.

8. EARNINGS PER SHARE

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares.

Basic EPS is calculated by dividing the net loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares on issue during the year, excluding shares held as treasury shares.

Diluted EPS is determined by adjusting the net loss attributable to ordinary shareholders and the weighted average number of ordinary shares on issue for the effects of all dilutive potential ordinary shares, which comprise treasury shares, options and restricted stock units (RSUs) granted to employees, directors and advisors. Potential ordinary shares are treated as dilutive when their conversion to ordinary shares would decrease EPS or increase the loss per share.

Year ended 31 March	2018 (000s)*	2017 (000s)*
Weighted average number of issued ordinary shares	137,566	137,366
Net loss after tax	(\$27,843)	(\$69,057)
Basic and diluted loss per share (in New Zealand dollars)	(\$0.20)	(\$0.50)

*Except for per share amounts

9. TRADE AND OTHER RECEIVABLES

Trade and other receivables are initially recognised at the fair value of the amounts to be received. They are subsequently measured at amortised cost (using the effective interest method) less impairment losses.

At 31 March	2018 (\$000s)	2017 (\$000s)
Accrued income	17,671	14,036
Prepayments	9,007	5,340
Trade receivables	5,525	11,843
Provision for doubtful debts	(225)	(157)
Government grant receivable	1,418	984
Rental bonds and other receivables	672	441
Interest receivable	455	330
Total current trade and other receivables	34,523	32,817

Trade receivables are related primarily to the monthly subscriptions charged for the Xero software. At 31 March 2018 trade receivables of the Group of \$444,000 were past due and are considered partially impaired (2017: \$423,000).

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at historical cost less depreciation.

Depreciation on assets is charged on a straight-line basis to allocate the differences between their original cost and the residual values over their estimated useful lives, as follows:

Leasehold improvements	Term of lease
Motor vehicles	5 years
Computer equipment	2 – 3 years
Furniture and equipment	2 – 7 years

The assets' residual values and useful lives are reviewed and adjusted if appropriate at each balance date. If an asset's carrying amount is greater than its estimated recoverable amount, the carrying amount is immediately written down to its recoverable amount.

	Leasehold improvements (\$000s)	Motor vehicles (\$000s)	Computer equipment (\$000s)	Furniture and equipment (\$000s)	Total (\$000s)
<i>Cost</i>					
Balance at 1 April 2017	14,002	147	6,331	9,558	30,038
Additions	8,265	–	3,964	2,674	14,903
Disposals	(5,198)	(120)	(4,502)	(1,436)	(11,256)
Foreign exchange adjustment	58	–	24	(35)	47
Balance at 31 March 2018	17,127	27	5,817	10,761	33,732
<i>Accumulated depreciation</i>					
Balance at 1 April 2017	6,402	135	3,009	4,611	14,157
Depreciation expense	3,724	12	2,454	1,861	8,051
Disposals	(5,110)	(120)	(3,075)	(1,431)	(9,736)
Foreign exchange adjustment	53	–	2	33	88
Balance at 31 March 2018	5,069	27	2,390	5,074	12,560
Net book value at 31 March 2018	12,058	–	3,427	5,687	21,172

	Leasehold improvements (\$000s)	Motor vehicles (\$000s)	Computer equipment (\$000s)	Furniture and equipment (\$000s)	Total (\$000s)
<i>Cost</i>					
Balance at 1 April 2016	11,649	214	6,183	8,864	26,910
Additions	3,417	–	2,999	1,198	7,614
Disposals	(685)	(67)	(2,676)	(299)	(3,727)
Foreign exchange adjustment	(379)	–	(175)	(205)	(759)
Balance at 31 March 2017	14,002	147	6,331	9,558	30,038
<i>Accumulated depreciation</i>					
Balance at 1 April 2016	4,685	152	3,351	3,260	11,448
Depreciation expense	2,536	32	2,355	1,712	6,635
Disposals	(669)	(49)	(2,618)	(291)	(3,627)
Foreign exchange adjustment	(150)	–	(79)	(70)	(299)
Balance at 31 March 2017	6,402	135	3,009	4,611	14,157
Net book value at 31 March 2017	7,600	12	3,322	4,947	15,881

11. INTANGIBLE ASSETS

Costs that are directly associated with the development of software are recognised as intangible assets where the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use
- management intends to complete the software product and use or sell it
- there is an ability to use or sell the software product
- it can be demonstrated how the software product will generate probable future economic benefits
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available
- the expenditure attributable to the software product during its development can be reliably measured

Software development costs that meet the above criteria are capitalised. Other development expenditure that does not meet the above criteria is recognised as an expense as incurred. Development costs previously recognised as expenses are not recognised as assets in a subsequent period. Software development costs recognised as assets are amortised over their estimated useful lives.

Other intangible assets acquired are initially measured at cost. Internally generated assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in the Income Statement when the expenditure is incurred.

With the exception of goodwill, the useful lives of the Group's intangible assets are assessed to be finite. Assets with finite lives are amortised over their useful lives and tested for impairment whenever there are indications that the assets may be impaired.

Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful life of the intangible asset, from the date it is available for use. The estimated useful lives are as follows:

Capitalised software development costs	3 – 5 years
Software licence costs	1 – 3 years
Patents, domains and trademark costs	10 years

Research costs and costs associated with maintenance are recognised as an expense as incurred.

Impairment considerations

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of the recoverable amount. Where the carrying value of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell or the asset's value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

The group recognised impairment losses of \$1.5 million during the year ended 31 March 2018 on write down of software development.

Goodwill is tested at least annually for impairment, or whenever indicators of impairment exist.

An impairment loss is recorded if its recoverable amount is less than its carrying amount. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate.

	Software development * (\$000s)	Software licences (\$000s)	Other intangible assets (\$000s)	Goodwill (\$000s)	Total (\$000s)
<i>Cost</i>					
Balance at 1 April 2017	185,093	2,004	941	5,352	193,390
Additions **	67,524	–	–	–	67,524
Disposals and write-offs	(13,042)	(65)	(477)	–	(13,584)
Adjustment due to change in tax rates	–	–	–	(187)	(187)
Balance at 31 March 2018	239,575	1,939	464	5,165	247,143
<i>Accumulated amortisation</i>					
Balance at 1 April 2017	66,307	858	606	–	67,771
Amortisation	45,614	964	47	–	46,625
Disposals and write-offs	(11,492)	(65)	(477)	–	(12,034)
Balance at 31 March 2018	100,429	1,757	176	–	102,362
Net book value at 31 March 2018	139,146	182	288	5,165	144,781

	Software development * (\$000s)	Software licences (\$000s)	Other intangible assets (\$000s)	Goodwill (\$000s)	Total (\$000s)
<i>Cost</i>					
Balance at 1 April 2016	138,489	2,807	975	5,352	147,623
Additions **	62,971	364	–	–	63,335
Disposals and write-offs	(16,367)	(1,167)	(34)	–	(17,568)
Balance at 31 March 2017	185,093	2,004	941	5,352	193,390
<i>Accumulated amortisation</i>					
Balance at 1 April 2016	48,840	415	589	–	49,844
Amortisation	33,834	1,610	51	–	35,495
Disposals and write-offs	(16,367)	(1,167)	(34)	–	(17,568)
Balance at 31 March 2017	66,307	858	606	–	67,771
Net book value at 31 March 2017	118,786	1,146	335	5,352	125,619

* Included in software development are projects in progress with a year end balance of \$5.5 million (2017: \$1.1 million)

** Includes \$9.0 million of externally purchased assets (2017: \$12.9 million)

Goodwill and goodwill impairment testing

Goodwill represents the excess of purchase consideration over the fair value of net assets acquired in a business combination. Goodwill is allocated to cash-generating units (CGUs), which are the lowest level of assets for which separately identifiable cash flows can be attributed. Xero's goodwill relates to the acquisition of Monchilla, Inc. and has been allocated to the North American CGU.

The recoverable amount of the North American CGU was calculated on the basis of value in use, using a discounted cash flow model. Future cash flows were projected for five years, with key assumptions being CGU earnings and capital expenditure for the CGU based on the market's forecasts of expected performance.

A terminal growth rate of 2.5% (2017: 2.5%) was applied and a pre-tax discount rate of 9% (2017: 12%) was utilised. The terminal growth rate is determined based on the long-term anticipated growth rate of the business. The forecast financial information is based on both past experience and future expectations of CGU performance. The major inputs and assumptions used in performing an impairment assessment that require judgement include revenue forecasts, operating cost projections, discount rates, terminal growth rates, and future technology paths.

During the year ended 31 March 2018 no impairment arose as a result of the review of goodwill. The recoverable amount of the North American CGU is greater than the carrying amount and, based on sensitivity analysis performed, no reasonable possible changes in the assumptions would cause the carrying amount of the CGU to exceed its recoverable amount.

12. TRADE AND OTHER PAYABLES

The Group recognises trade and other payables initially at fair value and subsequently at amortised cost using the effective interest method. The amounts are unsecured, and non-interest bearing.

At 31 March	2018 (\$000s)	2017 (\$000s)
Trade payables	7,383	11,352
Accrued expenses	13,461	16,568
Sales tax payable	5,441	4,792
Total current trade and other payables	26,285	32,712

13. OTHER CURRENT LIABILITIES

The Group recognises other current liabilities at fair value.

At 31 March	2018 (\$000s)	2017 (\$000s)
Income in advance	4,105	1,551
Financing loan	733	-
Other short-term liabilities	605	-
Total other current liabilities	5,443	1,551

Income in advance is recognised when the Group has received consideration prior to services being rendered.

During the year, Xero entered into a financing arrangement to fund upfront payments of a software licensing agreement. The balance of the loan represents borrowings for services not yet provided, with the final payment date being 31 May 2018.

14. PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Provisions relate to make-good obligations arising from leases of office space. The non-current portion is expected to be utilised by 2029.

	Make-good provision (\$000s)	Lease provision (\$000s)	Total (\$000s)
Balance at 1 April 2017	951	455	1,406
Provisions made during the year	799	-	799
Provisions utilised during the year	(10)	(455)	(465)
Provisions reversed during the year	(109)	-	(109)
Unwinding of discount	62	-	62
Foreign exchange adjustment	58	-	58
Balance at 31 March 2018	1,751	-	1,751
Current	10	-	10
Non-current	1,741	-	1,741

15. SHARE CAPITAL

	Note	2018 (000s)	2017 (000s)
Balance at 1 April		137,761	136,814
Issue of ordinary shares – employee restricted share plan	21	494	466
Issue of ordinary shares – exercising of employee share options	21	133	94
Issue of ordinary shares – director exercising options		–	34
Issue of ordinary shares – directors' fees		7	4
Issue of ordinary shares – restricted stock unit schemes	21	54	349
Ordinary shares on issue at 31 March		138,449	137,761
Treasury shares		(609)	(634)
Ordinary shares on issue at 31 March excluding treasury shares		137,840	137,127

All shares have been issued, are fully paid, and have no par value.

During the period, the Company allocated 600,095 shares under the employee restricted share plan (RSP), at an average price of \$26.03 (2017: 498,062, \$18.71). Of the shares allocated, 493,568 were new shares issued, and 106,527 were the reissue of shares held as treasury shares (2017: 466,180 and 31,882 respectively).

During the period, employees exercised 133,420 share options, with an average exercise price of \$17.58 (2017: 93,111, \$5.48).

During the period, the Company issued 7,131 shares at an average price of \$26.70 to directors in lieu of cash payment for directors' fees (2017: 3,957, \$19.11).

During the period, 59,888 restricted stock units (RSUs) vested, of which 53,816 were converted to shares with an average price of \$17.31. The remaining 6,072 were surrendered to settle payroll tax liabilities (2017: 519,372 vested, 349,049 converted at an average price of \$17.70).

16. RECONCILIATION OF OPERATING CASH FLOWS

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Net loss after tax	(27,843)	(69,057)
<i>Adjustments:</i>		
Depreciation	8,051	6,635
Amortisation	46,625	35,495
Deferred tax	(938)	(255)
Tax losses utilised	(483)	–
Loss/(gain) on foreign exchange transactions	723	(42)
Loss/(gain) on disposal of property, plant and equipment	(83)	70
Loss on disposal of intangible assets	1,549	–
Employee share-based payments	15,965	10,546
Non-employee share-based payments	1,039	1,177
Bad debts	1,336	813
Other non-cash items	–	107
<i>Changes in working capital:</i>		
Increase in trade receivables and prepayments	(602)	(5,969)
(Increase)/decrease in interest receivable	(125)	986
Increase/(decrease) in trade and other payables	(6,142)	8,635
Increase/(decrease) in current tax payable	(561)	794
Increase in employee entitlements	40	4,902
Increase in income in advance	2,600	762
Net cash flows from operating activities	41,151	(4,401)

17. KEY MANAGEMENT PERSONNEL AND RELATED PARTIES

Key management personnel

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, and include the directors, the Chief Executive, and his direct reports. The following table summarises remuneration paid to key management personnel.

Year ended 31 March	2018 (\$000s)	2017 (\$000s)
Short-term employee benefits	6,317	10,108
Directors' fees	926	486
Share-based payments – options	1,571	1,556
Share-based payments – restricted stock units	854	967
Share-based payments – employee restricted share plan	1,417	2,039

A number of key management personnel, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. A number of these entities subscribe to services provided by the Group. None of these related party transactions are significant to either party. These transactions are completed on arm's length terms. There were no other related party transactions during the year.

No amounts with any related parties have been written off or foregone during the year (2017: nil).

18. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES

Financial instruments

Financial instruments recognised in the Statement of Financial Position include cash and cash equivalents, short-term deposits, receivables and payables, and derivative financial instruments. The Group's policy is that no speculative trading in financial instruments shall be undertaken.

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Financial assets are impaired when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The carrying amount of an asset is reduced through the use of a provision account, and the amount of the loss is recognised in the Income Statement. When a receivable is uncollectible, it is written off against the provision account for receivables. Subsequent recoveries of amounts previously written off are credited against the Income Statement.

Capital management

The capital structure of the Group consists of equity raised by the issue of ordinary shares in the Company. The Group manages its capital to ensure that entities in the Group are able to continue as going concerns. As part of the Group's ongoing risk management, a NZD \$100 million syndicated (with BNZ and ANZ) stand-by debt facility was put in place in November 2017. This facility was put in place to provide additional liquidity headroom to navigate against unanticipated events. It is undrawn and there are no current plans to draw down on the facility. The facility agreement contains financial undertakings usual for facilities of this nature.

Classification and fair values

The Group has carried out a fair value assessment of its financial assets and liabilities at 31 March 2018 in accordance with NZ IFRS 13: *Fair Value Measurement*.

The Group's hedging derivatives are recognised at fair value. Fair values are calculated using forward exchange rates that are quoted in an active market (level two on the fair value hierarchy).

The carrying value of the Group's other financial instruments do not materially differ from their fair value.

	Loans and receivables (\$000s)	Hedging instruments at fair value (\$000s)	Financial liabilities at amortised cost (\$000s)	Total carrying value (\$000s)
At 31 March 2018				
<i>Assets</i>				
Cash and cash equivalents	20,955	–	–	20,955
Term deposits	59,000	–	–	59,000
Trade and other receivables	27,722	–	–	27,722
Derivative assets	–	2,549	–	2,549
Total financial assets	107,677	2,549	–	110,226
<i>Liabilities</i>				
Trade and other payables	–	–	20,844	20,844
Derivative liabilities	–	822	–	822
Total financial liabilities	–	822	20,844	21,666
At 31 March 2017				
<i>Assets</i>				
Cash and cash equivalents	27,699	–	–	27,699
Term deposits	86,000	–	–	86,000
Trade and other receivables	29,435	–	–	29,435
Derivative assets	–	818	–	818
Total financial assets	143,134	818	–	143,952
<i>Liabilities</i>				
Trade and other payables	–	–	27,608	27,608
Derivative liabilities	–	2,414	–	2,414
Total financial liabilities	–	2,414	27,608	30,022

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, credit risk and foreign currency risk.

Interest rate risk

The Group's interest rate risk arises from its cash and cash equivalents, and short-term deposit balances. Cash and cash equivalents comprise cash in hand, deposits held on at call with banks, and other short-term and highly liquid investments with original maturities of 90 days or less. Balances are placed on short-term deposit at fixed rates. The repricing of these exposes the Group to cash flow interest rate risk. The Group does not enter into interest rate hedges.

Management regularly reviews its banking arrangements to ensure it achieves the best returns on its funds while maintaining access to necessary liquidity levels to service the Group's day-to-day activities.

At 31 March 2018 if interest rates had been 1.0% higher/lower with all other variables held constant, the impact on the interest income, net loss and accumulated losses of the Group would have been \$0.8 million lower/higher (2017: \$1.1 million). This analysis assumes that the cash and cash equivalents, and short-term deposits balance was consistent with the year end balance throughout the year.

Liquidity risk

Liquidity risk is the risk that the Group cannot pay contractual liabilities as they fall due. At 31 March 2018 the Group held cash and cash equivalents of \$21.0 million and term deposits of \$59.0 million. The NZD \$100 million syndicated stand-by facility ensures the Group has sufficient liquidity to meet any unforeseen cash flow requirements in the foreseeable future.

The undiscounted contractual cash flows of the Group's non-derivative financial liabilities and assets are not significantly different to the carrying value and are due within 18 months or less. The Group's exposure to undiscounted gross cash flows from derivative financial liabilities are:

	Carrying amount (\$000s)	Contractual cash flows (\$000s)	0-6 Months (\$000s)	6-12 Months (\$000s)	12-18 Months (\$000s)
At 31 March 2018					
Forward exchange contracts	822	-	-	-	-
Inflows	-	50,625	40,780	9,845	-
Outflows	-	(51,278)	(41,334)	(9,944)	-
	822	(653)	(554)	(99)	-
At 31 March 2017					
Forward exchange contracts	2,414	-	-	-	-
Inflows	-	95,402	56,351	31,968	7,083
Outflows	-	(97,668)	(57,853)	(32,716)	(7,100)
	2,414	(2,266)	(1,502)	(748)	(17)

Credit risk

Where the Group has a receivable from another party, there is a credit risk in the event of non-performance by that other party. Financial instruments that potentially subject the Group to credit risk principally consist of cash and cash equivalents, short-term deposits, derivatives, and receivables.

The Group manages credit risk by placing cash and short-term deposits with high quality financial institutions. The credit risk associated with trade receivables is small because of the inherently low individual transaction value and the spread over many customers.

Maximum exposure to credit risk at balance date

At 31 March	2018 (\$000s)	2017 (\$000s)
Cash and cash equivalents	20,955	27,699
Short-term deposits	59,000	86,000
Trade and other receivables	25,516	27,477
Derivative financial assets	2,549	818
Non-current receivables	2,207	1,958
Total	110,227	143,952

Foreign currency risk

The Group faces the risk of movements in foreign currency exchange rates in relation to the New Zealand dollar. The Group has significant operations in three other currencies, being Great British pounds (GBP), Australian dollars (AUD), and United States dollars (USD). As a result, the Group's Income Statement and Statement of Financial Position are affected by movements in exchange rates.

The Group's exposure to monetary foreign currency financial instruments is outlined below in New Zealand dollars:

	AUD (\$000s)	USD (\$000s)	GBP (\$000s)
At 31 March 2018			
<i>Exposures</i>			
Cash and cash equivalents	4,583	1,642	5,816
Trade and other receivables	1,127	396	1,387
Trade and other payables	(2,949)	(3,948)	(3,767)
Derivative financial instruments	(68,781)	59,771	(30,541)
Total foreign currency exposure from financial instruments	(66,020)	57,861	(27,060)

At 31 March 2017

<i>Exposures</i>			
Cash and cash equivalents	5,551	6,299	1,898
Trade and other receivables	4,999	1,469	2,418
Trade and other payables	(3,608)	(7,539)	(3,082)
Derivative financial instruments	(80,830)	44,974	(9,996)
Total foreign currency exposure from financial instruments	(73,888)	45,203	(8,762)

Xero is exposed to currency risk from the operations of foreign subsidiaries and foreign currency denominated expenses in the Company. The significant exposures are USD outflows and AUD and GBP inflows. In order to reduce the impact of short-term movements in exchange rates, the Group's treasury policy requires a portion of the next 18 months' cash flows to be hedged with forward exchange contracts and vanilla options.

At 31 March a movement of 10% in the NZD would impact the Income Statement and Statement of Changes in Equity (after hedging) as detailed in the table below:

	10% decrease		10% increase	
	2018 (\$000s)	2017 (\$000s)	2018 (\$000s)	2017 (\$000s)
<i>Impact on:</i>				
Net earnings before income tax	(4,456)	(3,244)	3,646	2,654
Equity (before income tax)	(7,671)	(7,770)	6,211	6,357

This analysis assumes a movement in the NZD across all currencies and only includes the effect of foreign exchange movements on monetary financial instruments. All other variables remain constant.

19. HEDGE ACCOUNTING

The Group uses derivatives in the form of forward exchange contracts (FECs) and vanilla foreign exchange options (outright purchased options and vanilla collars) to reduce the risk that movements in the exchange rate will affect the Group's NZD cash flows. These hedges have been designated as a hedge of a highly probable forecast transaction (a cash flow hedge under NZ IAS 39: *Financial Instruments Recognition and Measurement*). The Group's policy is to hedge a portion of the next 18 months' forecasted cash flows.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are reclassified to the Income Statement in the periods when the hedged transaction affects profit and loss. Only the intrinsic value of options are designated in hedge relationships with movements in the time value of foreign exchange options recognised immediately in the Income Statement.

During the year, a net hedging gain of \$0.6 million (before taxation) was recognised in other comprehensive income (2017: loss of \$1.7 million). During the year, a loss of \$2.7 million (before taxation) was reclassified out of other comprehensive income to the Income Statement (2017: loss of \$3.8 million). The remaining balance will be reclassified to the Income Statement in the 18 months following 31 March 2018.

Hedge position

At 31 March		2018		2017
	2018	Notional	2017	Notional
	Fair value	amount	Fair value	amount
	(\$000s)	hedged	(\$000s)	hedged
		(NZD)		(NZD)
		(\$000s)		(\$000s)
Derivative assets				
Buy USD – Sell NZD	362	29,010	754	31,511
Buy NZD – Sell AUD	2,172	68,859	62	5,537
Buy NZD – Sell GBP	15	3,938	2	902
Total	2,549		818	
Derivative liabilities				
Buy USD – Sell NZD	(333)	30,748	(322)	13,194
Buy NZD – Sell AUD	(2)	2,121	(2,012)	73,470
Buy NZD – Sell GBP	(487)	18,031	(80)	9,082
Total	(822)		(2,414)	

20. CONTINGENCIES

There were no contingent liabilities at 31 March 2018 (2017: nil).

21. SHARE BASED PAYMENTS

The Group operates equity-settled, share-based compensation plans, under which employees provide services in exchange for non-transferable options, RSUs or shares. The value of the employee services rendered for the grant of non-transferable options, RSUs and shares is recognised as an expense over the vesting period, and the amount is determined by reference to the fair value of the options, RSUs and shares granted.

Employee restricted share plan

Under the Xero Limited employee restricted share plan (RSP), ordinary shares in Xero Limited are issued to a trustee, Xero Trustee Limited, a wholly owned subsidiary, and allocated to participants, on grant date, using funds lent to them by the Company.

The shares are beneficially owned by the participants. The length of retention period before the shares vest is up to three years. If the individual is still employed by the Group at the end of each specific period, the employee is given a cash bonus that must be used to repay the loan and shares are then transferred to the employee. The weighted average grant date fair value of restricted shares issued during the year was \$26.03 (2017: \$18.71) and was determined by the volume weighted average price of Xero Limited shares for the 20 trading days preceding the grant date. Shares with a grant date fair value of \$10.8 million vested during the year (2017: \$9.5 million). The Group has no legal or constructive obligation to repurchase the shares or settle the RSP for cash.

	2018 Number of shares (000s)	2017 Number of shares (000s)
Unvested shares at 1 April	582	608
Granted	600	622
Forfeited	(141)	(143)
Vested	(519)	(505)
Unvested shares at 31 March – allocated to employees	522	582
Forfeited shares not yet reallocated – held by Trustee	87	52
Total	609	634
<i>Ageing of unvested shares</i>		
Balance of shares to vest within one year	344	378
Balance of shares to vest after one year	178	204
Total unvested shares at 31 March	522	582

The number of shares awarded pursuant to the RSP does not equal the number of shares created for the scheme, as forfeited shares are held in the trust and reissued.

Share options scheme

Options are granted to selected employees, directors and service providers. The exercise price of the granted options is equal to the volume weighted average share price of Xero Limited shares for the 20 trading days preceding on the grant date.

Options are conditional on the completion of the necessary years of service (the vesting period) as appropriate to that tranche. The options' tranches vest over one to five years from the grant date. No options can be exercised later than the first anniversary of the final vesting date. There were 43 holders of options at 31 March 2018 (2017: 76).

The Group has no legal or constructive obligation to repurchase or settle the options in cash.

Movements in the number of options outstanding and their related weighted average exercise prices are as follows:

	2018 Weighted average exercise price (\$)	2018 Options (000s)	2017 Weighted average exercise price (\$)	2017 Options (000s)
Outstanding at 1 April	18.55	2,188	20.18	821
Granted	26.51	585	17.67	1,911
Forfeited/Expired	18.86	(415)	20.82	(416)
Exercised	17.58	(133)	8.26	(128)
Outstanding at 31 March	20.65	2,225	18.55	2,188
Exercisable at 31 March	22.09	747	24.66	249

The weighted average share price on date of exercise for options exercised in the year ended 31 March 2018 was \$25.20 (2017: \$18.54).

Options outstanding at the end of the year have the following expiry dates and exercise prices:

Granted	Expiry date	Exercise price (\$)	2018 Options (000s)	2017 Options (000s)
2013-14	2017-18	17.40	-	65
2013-14	2017-18	32.17	-	28
2013-14	2018-19	38.24	61	63
2014-15	2018-19	16.14	26	26
2015-16	2019-20	19.51	176	176
2015-16	2019-20	16.00	30	29
2016-17	2019-20	17.51	23	30
2016-17	2021-22	17.51	1,138	1,480
2016-17	2021-22	19.50	60	60
2016-17	2020-21	19.50	11	11
2016-17	2021-22	18.52	20	40
2016-17	2021-22	17.89	95	120
2016-17	2021-22	18.81	60	60
2017-18	2021-22	19.77	38	-
2017-18	2022-23	19.77	20	-
2017-18	2022-23	25.75	240	-
2017-18	2021-22	25.75	57	-
2017-18	2022-23	33.06	10	-
2017-18	2022-23	32.48	160	-
			2,225	2,188

The weighted average fair value of options granted during the year, determined using the Black-Scholes valuation model, was \$9.67 per option (2017: \$6.44).

The significant inputs into the model were the market share price at grant date, the exercise price as shown above, expected annualised volatility of between 38% and 41%, a dividend yield of 0%, an expected option life of between one and five years, and an annual risk-free interest rate of between 2% and 2.5%.

The volatility input is measured is the standard deviation of continuously compounded share returns and is based on a statistical analysis of daily share prices in the past one to five years.

Restricted stock units

RSUs are issued to certain employees and executives of the Group. On the grant date, an RSU agreement is entered into between employee and Company stipulating the number of units granted and their vesting schedules. On the vest date, the RSUs are converted to ordinary shares.

No cash consideration is required to be paid to exercise the RSUs. The fair value of RSUs granted in the year ended 31 March 2018 was \$5.8 million (2017: \$5.6 million) as determined by the volume weighted average share price. The RSUs are conditional on the employees completing up to three years' service (the vesting period) and are, for the most part, exercisable in equal amounts over the vesting period.

	2018 Weighted average grant price (\$)	2018 RSUs (000s)	2017 Weighted average grant price (\$)	2017 RSUs (000s)
Outstanding at 1 April	17.41	327	17.30	705
Granted	26.31	222	18.72	299
Forfeited	21.93	(88)	18.15	(156)
Converted to shares	17.31	(54)	17.64	(349)
Surrendered to pay payroll tax	20.21	(6)	17.59	(172)
Outstanding at 31 March	21.64	401	17.41	327

The Group withholds shares under certain circumstances to settle tax obligations on vesting. Based on the market share price on 31 March 2018, future cash payments to meet tax obligations are expected to be \$3.9 million (2017: \$2.4 million).

22. COMMITMENTS

Operating lease commitments

The Group leases offices, motor vehicles, and laptops under non-cancellable operating lease agreements. The lease terms are between 1 and 13 years. A number of lease agreements are renewable at the end of the lease periods at a market rate.

The future minimum lease payments under non-cancellable operating leases are as follows:

At 31 March	2018 (\$000s)	2017 (\$000s)
Within one year	17,913	9,647
After one year but not more than five years	53,077	34,025
More than five years	52,567	17,914
	123,557	61,586

Xero leases properties that have been sublet as they are surplus to requirements. The leases and subleases are on equivalent terms.

The total future minimum sublease payments expected to be received under non-cancellable subleases for office space at 31 March 2018 is \$2.5 million (2017: \$1.3 million).

Capital commitments

Capital commitments of \$0.9 million for building fit-outs were contracted for at 31 March 2018 but not yet incurred (2017: \$9.4 million).

23. GROUP ENTITIES

Consolidation subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions and balances between Group companies are eliminated on consolidation.

The financial statements of each of the Group's subsidiaries are prepared in the functional currency of that entity. The functional currency is determined for each entity based on factors such as the principal trading currency. The assets and liabilities of these entities are translated at exchange rates existing at balance date. Revenue and expenses are translated at rates approximating the exchange rates ruling at the dates of the transactions. The exchange gains or losses arising on translation are recorded in other comprehensive income and accumulated in the foreign currency translation reserve in equity.

	Principal activity	Country of incorporation	Balance date	Interest 2018 (%)	Interest 2017 (%)
Xero (NZ) Limited	Reseller	New Zealand	31 March	100	100
Xero (UK) Limited	Reseller	United Kingdom	31 March	100	100
Xero Australia Pty Limited	Reseller	Australia	31 March	100	100
Xero, Inc.	Reseller	United States	31 March	100	100
Xero (Singapore) Pte. Ltd	Service provider	Singapore	31 March	100	100
Xero Software (Canada) Ltd	Service provider	Canada	31 March	100	-
Xero (HK) Limited	Service provider	Hong Kong	31 March	100	-
Xero South Africa (Pty) Ltd	Service provider	South Africa	31 March	100	-
Monchilla, Inc.	Non-active	United States	31 December	100	100
Xero Trustee Limited	Trustee	New Zealand	31 March	100	100

24. EVENTS AFTER THE BALANCE SHEET DATE

No matters or circumstances have arisen between 31 March 2018 and the date of this report that have significantly affected or may significantly affect the operations of the Group, the results of those operations, and the state of affairs of the Group in future years.

DIRECTORS' RESPONSIBILITIES STATEMENT

The directors are required to prepare financial statements for each financial year that present fairly the financial position of the Group and its operations and cash flows for that period.

The directors consider these financial statements have been prepared using accounting policies suitable to the Group's circumstances, that these have been consistently applied and are supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy, at any time, the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1993 (New Zealand). They are also responsible for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

During the year ended 31 March 2018, the principle activities of the Group were for the provision of an online accounting platform to small businesses and their advisors. Other than as disclosed in this Annual Report, there were no significant changes in the state of affairs or activities of the Group during the year.

The Board authorised these financial statements for issue on 10 May 2018.

For and on behalf of the Board



Graham Smith

Chair
Xero Limited
10 May 2018



Lee Hatton

Director
Xero Limited
10 May 2018

**CORPORATE
GOVERNANCE
AND
DISCLOSURES**

5

**THE
DETAILS
MATTER**

CORPORATE GOVERNANCE STATEMENT

Xero Limited (Xero) is committed to high standards of corporate governance. We believe this is essential for the long-term performance and sustainability of Xero and supports the interests of our shareholders. The Xero Board of Directors (the Board) is responsible for ensuring that Xero has an appropriate corporate governance framework to protect and enhance Xero's performance and to build sustainable value. Xero's corporate governance framework is designed to support our business operations, deliver on our strategy, monitor performance, and manage risk.

Xero has had a sole listing on the Australian Securities Exchange (ASX) since 5 February 2018, but remains a New Zealand incorporated and domiciled company. From a regulatory perspective, this means that while the ASX Listing Rules will apply to Xero, certain provisions of the Australian Corporations Act 2001 (Cth) will not.¹

Xero's corporate governance reporting framework has been developed with regard to the ASX Listing Rules and the ASX Corporate Governance Principles and Recommendations (3rd Edition). This Corporate Governance Statement (Statement) addresses the recommendations contained in the ASX Principles and Recommendations. This Statement is current as at 27 April 2018, and has been approved by the Board.

This Statement should be read in conjunction with this Annual Report and the Investor section of Xero's website at www.xero.com/about/investors/governance, where there are further details on Xero's corporate governance policies and charters.

1. Xero complies with the ASX Listing Rules. As Xero is not incorporated in Australia, it is not a disclosing entity for the purpose of Chapter 2M of the Australian Corporations Act 2001 (Cth) (Financial reports and audits) and certain provisions thereof will not apply (eg section 295 on Annual Financial Report, section 298 regarding Directors Report or Section 300A regarding remuneration reporting). As a New Zealand company, Xero's annual reporting is primarily governed by the Companies Act 1993 (New Zealand)

ASX PRINCIPLES AND RECOMMENDATIONS

PRINCIPLE 1: LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

The Board

Charter The Board's Charter outlines the Board's roles and responsibilities and describes those matters expressly reserved for the Board's determination and those matters delegated to management.

Xero's CEO has responsibility for the day-to-day management and administration of the Xero business, and is supported in this function by Xero's leadership team. The CEO manages Xero in accordance with the strategic plan, annual budget, and the strategies approved by the Board for managing risks.

The Board comprises directors who bring an appropriate mix of skills, knowledge, experience, diversity and independence, together with a proper understanding of, and competence to deal with, current and emerging issues to guide the business.

Xero's Board Charter was updated during the reporting period, and is available on Xero's website.

Responsibilities The Board retains full responsibility for overseeing and appraising Xero's strategies, policies and performance, and the governance framework. To assist the Board with discharging its responsibilities, it has established the following committees:

1. Audit and Risk Management Committee
2. People and Remuneration Committee
3. Nominations Committee

From time to time, the Board may form other committees or delegate specific functions to ad hoc committees.

The Board is responsible for monitoring the management and performance of the Xero business and for ensuring that management's activities are aligned with the expectations and risks identified by the Board and management. The Board has a number of mechanisms to ensure this is achieved, including:

1. Approving Xero's corporate strategic plan, and overseeing performance to ensure its performance is aligned with the strategic plan
2. Focusing Xero's objectives on long-term shareholder value
3. Adopting an annual budget for financial performance and monitoring progress against that budget
4. Confirming systems are in place to identify, manage, and mitigate risks, and that there are accurate and reliable reporting systems in place

Other functions reserved to the Board include:

1. Selecting, appointing, evaluating, removing (if necessary), and overseeing the succession of the CEO
2. Confirming that Xero's financial position is sound and that it is able to meet its debts and other obligations when they are due, and that Xero has sufficient financial resources to achieve its strategic plan
3. Assessing that an appropriate culture and management framework is in place
4. Determining that Xero's governance policies and practices are appropriate and are aligned with interests of shareholders and relevant laws and regulations
5. Ensuring that any significant risks that arise are identified, assessed, appropriately managed, and monitored

Appointment Before electing a candidate as a director, Xero undertakes appropriate background checks to determine that candidate's suitability.

Board and Committee membership and meeting attendance The members of Xero's Board and each of Xero's committees during the reporting period, the number of meetings of the Board and each committee held during the reporting period, and the Board and committee members attendance at those meetings is:

Director	Board		Nominations Committee		Audit and Risk Management Committee		People and Remuneration Committee	
	Held ¹	Attended	Held ¹	Attended	Held ¹	Attended	Held ¹	Attended
Mr Rod Drury	7	7	-	-	-	-	-	-
Mr Craig Elliott ³	3	2	-	-	-	-	2	2
Ms Lee Hatton	7	6	-	-	4 ²	4	4	4
Ms Susan Peterson	7	7	-	-	-	-	4	4
Mr Graham Smith	7	7	4 ²	4	4	4	-	-
Mr Bill Veghte	7	6	4	4	-	-	4 ²	4
Mr Craig Winkler	7	7	4	4	4	4	-	-

1. Held represents the number of meetings held that the relevant director was eligible to attend

2. Committee Chair

3. Resigned as a director effective 12 July 2017

The qualifications of each director are detailed on page 24 of this Annual Report.

All directors and members of Xero's leadership team are appointed pursuant to formal letters of appointment or agreements setting out the key terms and conditions of their appointment (including remuneration and other duties). Director appointment letters also include further details regarding committee responsibilities, directors' duties and responsibilities, the time commitment envisaged, Board performance evaluation, confidentiality of information, the Board's policy on obtaining independent advice, disclosure of interests and matters affecting independence, and entering into deeds of indemnity, insurance, and access.

Company Secretary Chaman Sidhu is the Company Secretary of Xero. Ms Sidhu's qualifications and experience are set out on Xero's website.

The Company Secretary is accountable to the Board, through the Chair, on all matters to do with the proper functioning of the Board. The formal reporting line of the Company Secretary is through the Chief Operating and Financial Officer (COFO). All directors have access to the Company Secretary.

Diversity and inclusion

Xero values diversity and inclusion and considers it a priority in the creation of a sustainable business capable of delivering long-term shareholder value. Xero embraces the diverse experience, ideas, skills and perspectives of our people. Having a diverse workforce enables Xero to innovate, attract and retain top talent, and to better reflect and serve our customers, partners, and the communities we interact with every day. Xero takes a broad view of the meaning of diversity and believes that it is through inclusion that the company will tap into the potential and power of our people's differences.

Diversity and Inclusion Policy During the reporting period, Xero implemented a new Diversity and Inclusion Policy, which is available on Xero's website. This policy includes requirements for the Board to establish measurable objectives for achieving diversity and to annually assess those objectives and the progress towards achieving them.

The Diversity and Inclusion Policy reflects six key principles that provide the framework for Xero's goal of developing and maintaining a diverse and inclusive workplace and the implementation of Xero's initiatives to support this. The key principles are:

1. We value diversity because it reflects and serves our customers and ensures our people thrive
2. We're all accountable to create an inclusive culture
3. We're committed to attracting diverse talent and hiring fairly
4. We support flexible ways of working
5. We're committed to equal pay for equal work
6. We have an obligation to champion diversity and inclusion in the community

Xero also recently implemented a global Respect and Responsibility Policy to support a clear and consistent approach to equal opportunity and to promote a workplace free from discrimination, harassment, and bullying.

Xero's Australian subsidiary submits an annual Workplace Gender Equality Report under the Australian Workplace Gender Equality Act 2012, available on the WGEA's website at www.wgea.gov.au.

Measurable objectives The following is a summary of progress achieved against Xero's measurable objectives for the reporting period:

Objective	Progress
Xero attracts diverse talent in the technology industry with particular focus on women in technology	<ul style="list-style-type: none"> - At 31 March 2018, 40% of employees are female and 40% of Xero's leadership team are female - Implemented a new Diversity and Inclusion Policy and appointed a Head of Diversity, Inclusion and Community in 2017 - Continued to incorporate diversity and inclusion in Xero's external communications and activities, including recruitment activities - Maintained our support of organisations and initiatives to attract a more gender diverse workforce, including Girl Geek Dinners, Girls in Tech, Code Like A Girl, Tech Girls Movement, and WORK180 - Launched a pilot internal mentoring programme for our female employees in New Zealand - Delivered a global International Women's Day campaign - Commenced our support of Return to IT, a program that supports women returning to work in the technology sector in Wellington, New Zealand - Initiated the process of a gender pay review to assess the parity of pay across the organisation
Xero promotes flexible working across the organisation where possible	<ul style="list-style-type: none"> - Maintained Xero's Flexible Working Guidelines and the Manager's Guide to Flexible Working - Developed and piloted a workshop to educate managers on supporting flexible working arrangements - Actively communicated real stories of employees working in flexible work arrangements - Delivered internal surveys to understand the utilisation and satisfaction with flexible work arrangements - Developed guidelines for managers to promote an inclusive environment for employees on parental leave - Launched a pilot "family room" in Xero's Melbourne office
Xero is an inclusive work environment where difference is valued and everyone can bring their whole self to work	<ul style="list-style-type: none"> - Delivered training on topics including diversity, inclusion, bias awareness, and LGBTI awareness to some employees throughout the business - Implemented disability confidence training to key human resources and recruitment employees - Delivered surveys to capture feedback on the extent to which employees feel that Xero is an inclusive workplace - Joined organisations supporting LGBTI workplace inclusion - Pride in Diversity in Australia and Stonewall in the United Kingdom - Delivered a World Mental Health day video of employees suggesting ways they can look after their mental health - Delivered awareness sessions in New Zealand to provide employees and managers with practical strategies to promote wellbeing - Delivered internal communications to employees to educate and promote the importance of diversity and inclusion and held shared cultural lunches

Gender diversity statistics The number of women at Xero was as follows¹:

At 31 March	2018 women	2018 men	2018 total	2018% women	2017 women	2017 men	2017 total	2017% women
Directors ²	2	4	6	33%	2	5	7	29%
Leadership team ³	4	6	10	40%	4	8	12	33%
Employees	814	1,191	2,010 ⁴	40%	651	1,028	1,681 ⁵	39%

1. These figures include permanent full-time, permanent part-time, and fixed-term employees, but not contractors

2. Dale Murray was appointed to the Board on 13 April 2018. If Ms Murray was included in the statistics, there would be a total of 3 female directors on the Board and the proportion of female directors would be 43%

3. Xero's leadership team means the CEO and all direct reports to the CEO. Due to changes in reporting lines during the financial year, certain individuals included as "Officers" in Xero's 2017 Annual Report are not included as part of Xero's leadership team for the purpose of this disclosure

4. Xero has an optional self-selection gender identification question that allows employees to choose from the following options: female, male, other, and not declared. Employees can also leave this question unanswered. In 2018, two employees selected other, and three employees selected not declared and are included in the total. 44 employees were excluded from the total because they did not respond to the gender identification question. If these 44 employees were included in the total number of employees but not assigned a gender, the proportion of females of that total would still be 40%

5. In 2017, two employees selected not declared and are included in the total

Evaluation of the Board

In accordance with the Board Charter, the performance of the Board is reviewed annually, assisted by the Nominations Committee. The Nominations Committee assists in developing and implementing a process to review and evaluate the performance of the Board (including its performance against the requirements of the Board Charter), Committees, and directors.

These performance reviews are conducted both internally and, on a periodic basis, externally with the assistance of a facilitator. The most recent review was conducted internally during the reporting period and was led by the Chair. This review evaluated the Board, Committee, and individual director performance.

The Board, with guidance from the Nominations Committee, determines the size and composition of the Board (having regard to the size of Xero), and the appointment, re-election or retirement of directors. A director does not participate in the decision regarding their own re-election.

After considering the results of the performance reviews, the Board determines whether it will endorse the directors who will stand for re-election at the Annual General Meeting (AGM).

Evaluation of leadership team

The CEO, with oversight from the People and Remuneration Committee, reviews and makes recommendations on the performance evaluation of Xero's leadership team.

The performance of Xero's leadership team has historically been reviewed every six months, against both quantitative and qualitative indicators. In future reporting periods this will change to an annual review. The CEO conducts the performance review by assessing each executive's performance against specific and measurable quantitative and qualitative performance criteria. The assessment is then discussed with the People and Remuneration Committee. The performance criteria against which the executives are assessed is aligned with the financial and non-financial objectives of Xero.

Two performance evaluations for the leadership team took place during the reporting period in accordance with the process referred to above.

PRINCIPLE 2: STRUCTURE THE BOARD TO ADD VALUE

Nominations Committee

The Board has established a Nominations Committee that operates under a Charter, which is available on Xero's website. The Charter provides that the Committee will consist of a majority of independent directors, be chaired by an independent non-executive director, and have at least three members. The current Committee composition meets these requirements. The Committee meets at least three times per year and all directors have a standing invitation to attend Committee meetings.

Responsibilities The Committee's role is to assist the Board in relation to:

- Board and Committee size and composition
- Director selection, appointment, election, and re-election
- The selection, appointment and if necessary, termination of the CEO
- Director induction and continuing professional development
- Evaluating the performance of the Board, its Committees, and individual directors
- Succession planning for the Board (in particular the Chair) and the CEO

Board skills matrix

Skills/Experience/ Knowledge	Number of directors with this skill at 31 March 2018
Listed Public Company (as non-executive director or executive)	6
Technology (technology, e-commerce, cloud)	6
Digital Product / Online	4
Financial Accounts Literacy	6
Strategy	6
Risk Management	6
International Business	5
Accounting Industry	4

Director appointment The Board's policy and procedures for selecting and appointing new directors to the Board is to identify and consider qualified potential candidates, in light of the appropriate mix of skills, knowledge, experience, diversity, and independence that the Board and Committees are seeking to achieve, and the time commitment required from non-executive directors.

Suitable candidates are appointed by the Board, which may nominate and appoint directors to the Board to fill casual vacancies. Directors appointed to fill casual vacancies hold office until Xero's next AGM and are then eligible for election.

In determining Board membership, the Board seeks to achieve a mix of skills and diversity that includes experience in international business, digital media, financial accounting, technology, risk management, and governance.

The table below provides a summary of the directors' relevant skills as at 31 March 2018.

Skills/Experience/ Knowledge	Number of directors with this skill at 31 March 2018
Legal and Corporate Governance	5
People - Human Resources, Remuneration, and Diversity	5
Small Business	5
Executive/Senior Management	6
Mergers and Acquisitions	6
Marketing	4
Government, Public Policy, or Regulatory	4

The Board is satisfied that the skills matrix demonstrates that the Board has the appropriate mix of skills and experience necessary to oversee the governance and operations of Xero.

Independence

Xero considers a director to be independent when they are a non-executive director who is independent of management and free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their unfettered judgement, having regard to the best interests of Xero as a whole.

In the context of director independence, “materiality” is considered from both Xero and an individual director perspective.

The Board makes an assessment of the independence of each director upon their appointment and annually thereafter. Directors are required on an ongoing basis to disclose to the Board relevant personal interests and conflicts of interest. In accordance with the definition of independence above, and having regard to the relevant factors listed in the ASX Principles and Recommendations, the following directors of Xero are considered to be independent:

- Mr Graham Smith (Chair)
- Ms Lee Hatton
- Ms Susan Peterson
- Mr Bill Veghte
- Ms Dale Murray (appointed as a director on 13 April 2018)

The length of service of each director is ascertainable from the information on page 24 of this Annual Report.

Board composition and Chair

The Board Charter sets out that the Board will consist of a majority of independent non-executive directors. The Chair of Xero, Graham Smith, is assessed as an independent non-executive director. The Chair’s role is to lead the Board, facilitate constructive discussion at Board meetings, and ensure that the Board functions effectively.

Induction

All new Board members are given an appropriate induction programme to enable new directors to gain an understanding of Xero, its operations and values, its financial, strategic, and risk management position, and the rights, duties and responsibilities of the Board, its Committees and management. Each new Board member has the opportunity to meet with existing Board members, Xero’s leadership team, and relevant members of the senior management team. All Board members are expected to maintain the skills required to discharge their respective roles.

PRINCIPLE 3: ACT ETHICALLY AND RESPONSIBLY

Code of Conduct

Xero has a Code of Conduct that applies to everyone who works at Xero. The Code captures the standards and values of Xero and sets out the way Xero conducts business and how we believe we should behave. The Code is underpinned

by Xero policies, some of which are global and some of which are country specific, and include topics covering diversity and inclusion, fraud, respect and responsibility, workplace behaviour, and work health and safety.

Xero reviewed its Code of Conduct during the reporting period and is in the process of finalising a revised code. It is intended that the revised code will apply to all directors, officers, employees, and contractors.

The Code of Conduct is available on Xero’s website and is also made available to employees via Xero’s intranet.

PRINCIPLE 4: SAFEGUARD INTEGRITY IN CORPORATE REPORTING

Audit and Risk Management Committee

Purpose The Board has established an Audit and Risk Management Committee (ARM Committee) that operates under a Charter, which is available on Xero’s website. The ARM Committee has been established to review and make recommendations to the Board on areas including financial reporting principles and policies, risk management, compliance, external audit functions, and internal control processes.

Composition The ARM Committee Charter states that the Committee will comprise at least three members. All members must be non-executive directors, and the majority must be independent. The Committee is to be chaired by an independent member, who is not the Chair of the Board. The Charter also states that the members should be financially literate, and at least one member will have accounting or related financial management expertise. The current Committee composition meets these requirements.

The ARM Committee Charter provides that the Committee will meet at least four times per year. The COFO and Chief Accounting Officer are routinely invited to attend meetings of the Committee, and other senior managers are invited to relevant parts of the meetings.

Details of the membership of the ARM Committee and attendance at its meetings are set out in Principle 1.

Responsibilities The ARM Committee is responsible for reviewing and making recommendations to the Board on areas including the following:

1. The financial statements and reports intended for publication at half-year and full-year
2. The adequacy of accounting policies, processes and financial reporting practices, and ensuring appropriate new policies and revisions to existing policies are made to ensure compliance with relevant accounting standards
3. Approval of the appointment, reappointment or replacement, and remuneration of the external auditor
4. The provision of non-audit services by the external auditor, and whether it may compromise the independence of the external auditor

5. The overall adequacy and effectiveness of the internal control systems, controls to safeguard assets, compliance with applicable laws, ethical compliance, and insurance coverage
6. The overall adequacy and effectiveness of the risk management framework and the methodology and processes for assessing, monitoring, and managing financial and non-financial risks

Reporting The Chair of the ARM Committee communicates the findings of the Committee to the Board at the next Board meeting.

To ensure that the external auditor remains independent at all times, non-audit work is authorised by the ARM Committee.

Xero is committed to ensuring the external auditor carries out its function independently and has adopted an Auditor Independence Policy. The policy requires that the senior audit partner must be rotated at least every five years. The auditor was last changed in 2015. The policy also requires the external auditor to confirm annually that it has complied with all professional regulations relating to auditor competency and independence.

The external auditor will attend and be available to answer shareholder questions at the AGM.

Declaration regarding financial statements

As a New Zealand company, section 295A of the Australian Corporations Act 2001 (Cth) is not applicable to Xero. However, the CEO and the COFO will provide written statements to the Board in accordance with the ASX Principles and Recommendations, in respect of the half and full-year reporting periods. The statements will confirm that in their opinion, the financial records of Xero have been properly maintained and that the financial statements comply with the accounting standards and give a true and fair view of the financial position and performance of Xero, and that their view is founded on the basis of a sound system of risk management and internal control which is operating effectively in all material respects.

PRINCIPLE 5: MAKE TIMELY AND BALANCED DISCLOSURE

Disclosure Policy

Xero's Continuous Disclosure Policy (previously the Market Disclosure Communications Policy), was revised during the reporting period and is available on Xero's website. The policy describes the key obligations of the Board and Xero's leadership team to ensure that Xero complies with its disclosure obligations under the ASX Listing Rules. The Board is responsible for compliance with Xero's continuous disclosure obligations. It has established a Disclosure Committee, comprising the CEO, a director, the COFO, and the General Counsel and Company Secretary to support this

primary responsibility and provide assurance. Xero's General Counsel and Company Secretary is primarily responsible for overseeing and coordinating all communications with the ASX, and is the Disclosure Officer for the purpose of the policy. The Authorised Spokespersons of Xero include the Chair, the CEO, the COFO, the Director of Corporate Affairs, and any other person authorised by the CEO.

PRINCIPLE 6: RESPECT THE RIGHTS OF SECURITY HOLDERS

Shareholder communication

Xero communicates all important information relevant to Xero to its shareholders, and provides for two-way communication with investors. Xero has an investor relations function which, in collaboration with the company secretariat function, has a program and practices to enable Xero to meet this aim including the following:

1. The Investor Centre on Xero's website is accessible by shareholders and updated in a timely manner. Copies of Board and Committee Charters and policies are made available in the Governance section of the Investor Centre and ASX and media releases are made available on Xero's website, after they have been released. The half and full-year financial results and investor presentations are available in the Financial Information section of the Investor Centre
2. Investors can send enquiries directly to the Xero investor relations function by using the online form in the Investor Centre
3. The details of Xero's share registrar, Link Market Services Limited, are available to investors in the Investor Centre
4. Shareholders can sign up to monitor Xero's ASX announcements via the ASX
5. Shareholders can elect to communicate with Xero's share registrar electronically
6. The Annual Report is distributed to shareholders, either electronically or by post, and includes relevant information about the operations of Xero and other required disclosures
7. Each shareholder receives a Notice of Meeting invitation, is encouraged to attend the AGM, and has the opportunity to attend and participate in the meeting. Shareholders have the ability to vote electronically or to appoint a proxy. For the last two years, Xero has held a hybrid AGM, meaning shareholders can attend the meeting in person or virtually via an online platform. If shareholders attend the AGM virtually, they are able to watch the AGM live, vote, and ask questions online

PRINCIPLE 7: RECOGNISE AND MANAGE RISK

Audit and Risk Management Committee

Purpose As mentioned in Principle 4, the Board has established an Audit and Risk Management Committee (ARM Committee) that operates under a Charter, which is available on Xero's website.

The Board is ultimately responsible for ensuring that material risks facing Xero have been identified and that adequate controls, monitoring, and reporting mechanisms are in place and operating effectively. The Board has delegated its oversight of risk management, audit, and compliance to the ARM Committee.

The ARM Committee operates in accordance with its Charter, which sets out its responsibilities for monitoring Xero's risk management, including how Xero identifies, assesses, and controls strategic, operational, and financial risks within the Board approved risk appetite. This is designed to ensure the adequacy and effectiveness of Xero's ongoing risk management program, including policies and guidelines relating to corporate governance, legal, regulatory and ethical compliance, business continuity management, data privacy, and information systems security.

Risk framework

Xero has a risk management framework which is managed by the company's strategy function (reporting to the COFO) and overseen by the ARM Committee.

The strategy function has conducted workshops across the business with Xero's leadership team, senior management, and operational specialists. The workshops assess areas of potential risk to the business and develop mitigation strategies. The identified discrete risks are included in a report outlining the key risk categories, including operational, strategic, legal, and financial. It is intended that the report be reviewed by the ARM Committee twice each year, to reflect any key changes in the risk environment.

Risks lying outside the boundaries of Xero's agreed risk appetite require proactive mitigation and are included as part of an ongoing action plan, which is tracked and monitored on a periodic basis by Xero's leadership team, with oversight from the ARM Committee.

The ARM Committee has reviewed Xero's overall risk management framework during the current reporting period and considers that it is sound.

Internal audit

Xero has not yet implemented an internal audit function due to the relatively smaller size of the revenue base and the high levels of automation implemented within Xero. Xero operates an internal control environment through enforcement of system based access and manual controls. Effectiveness of mitigating controls are assessed against identified financial and business risks through periodic reviews. Xero has used external consultants to perform internal audit type functions to improve the control environment in specific areas.

In addition, Xero's risk management framework identifies key risks and provides mitigation strategies. The strategy function that manages the risk management framework is independent of the external auditor.

With the increasing size and scope of the business, Xero will regularly assess the appropriate timing for the creation of a dedicated internal audit function.

Management of economic, environmental, and social sustainability risks

There are a number of business risks that could materially impact Xero. As part of the risk management process described above, Xero has identified and assessed those areas of risk that may impact the business. Effective monitoring and mitigation of these risks supports Xero's ongoing growth and profitability. Key areas of risk are described below. Other risks relevant to economic sustainability are noted on pages 62-64 of this Annual Report in the Notes to the Financial Statements.

Data security Xero is committed to the security of its customers' data and has partnered with industry-leading security vendors to leverage their platforms and expertise to protect its systems. Xero has a security team that is responsible for security risk management, product and platform security, security operations, security compliance, and training and awareness.

Xero takes a risk-based approach to security, which means tighter security controls are implemented where business risk is higher. In order to manage security risks within Xero's risk appetite, processes are in place for identification, assessment, and treatment of security risks.

Xero hosts its data in Amazon Web Services (AWS) at two data centres located in the US. Both data centres have the same security measures to protect Xero's and its customers' data.

Xero has the following enterprise-wide security practices and procedures in place:

- an information security management framework
- an information security policy
- information security standards
- an internal security governance group, which meets regularly

Xero has in place a Business Continuity Management policy and plans and a Data Classification Standard. Xero produces a SOC 2 (Service Organization Control 2) report annually which is the result of an independent assessment of controls in place for security, confidentiality, and availability.

Strategic direction and implementation A clear and disciplined approach to strategic choices and delivery is key to success as Xero grows and pursues a wider range of strategic objectives in more markets. With the oversight of the Board, Xero's leadership team reviews the strategic direction on an ongoing basis and shares learnings from across the

business as well as incorporating the impact of external developments as required. Underlying initiatives are reviewed and updated, assigned owners, and tracked on a regular basis.

Innovation momentum and delivery It is critical that Xero maintains its ability to stay ahead of the competition and continues to build and deliver innovative products and services to customers as it has in the past, providing Xero with a competitive advantage.

Xero proactively aligns our teams with our strategy to more rapidly and efficiently advance our goals. We have processes to monitor progress, as well as enabling delivery through improving Xero's product management capability. This foundation of strategic alignment, tracking, oversight, and capability development supports Xero's ongoing delivery of product innovation.

Access to talent As Xero grows, it requires more talent working across the globe. The organisational architecture needs to constantly evolve to serve more independent teams in more diverse locations. In addition to current strategies to attract talent into current locations, alternative approaches are being explored to attract talent to new locations.

Financial liquidity risk Xero is executing on a plan to become cash flow break-even within the company's current cash balance, without drawing on Xero's debt facility. This undrawn bank facility was put in place during the reporting period to provide liquidity risk mitigation. Xero assesses financial liquidity risk on an ongoing basis.

PRINCIPLE 8: REMUNERATE FAIRLY AND RESPONSIBLY

People and Remuneration Committee

Purpose Xero has a People and Remuneration Committee (P&R Committee) that operates under a Charter, which is available on Xero's website. The P&R Committee has the role of assisting the Board in overseeing the human resources activities of Xero. The P&R Committee's principal function is to oversee Xero's strategies and policies relating to organisational structure, culture, employee performance and development, succession planning, growth, and remuneration.

Composition The P&R Committee Charter states that the Committee will consist of a minimum of three non-executive directors, the majority of whom are independent, and that it is chaired by an independent member. The current Committee composition meets these requirements.

Further details of the membership of the P&R Committee and attendance at its meetings are set out in Principle 1.

Responsibilities The P&R Committee Charter sets out the responsibilities of the P&R Committee to review and make recommendations to the Board on:

1. Remuneration of the Board
2. Executive remuneration, including the remuneration of

Xero's leadership team

3. Xero's remuneration strategy, structure and policy, and short and long-term incentive plans, including amendments to such plans, and other material employee benefits
4. The measurable objectives for achieving diversity
5. Management succession planning for key roles within Xero

Remuneration policy and practices

Xero is dependent on highly-skilled employees who specialise in a broad range of disciplines. Our ability to implement a competitive strategy to attract, retain, reward, and motivate our people, is fundamental to our long-term success. To align employee interests with shareholders, Xero has a remuneration policy and remuneration practices geared toward objectives, including to:

- differentiate and reward excellent performance and key talent, both in the short and long-term, and recognise our values
- enable Xero to attract and retain employees, and motivate them to achieve results with integrity and fairness, while being market-competitive
- balance the mix of fixed and variable compensation to reflect the value and responsibility of a role, and influence appropriate behaviours and actions to support a growing business
- ensure that objectives linked to remuneration are aligned to Xero's overall strategy
- foster teamwork and collaboration across Xero
- take into account the long-term performance of Xero in order to create sustainable value for our shareholders
- ensure diversity has no influence on employees' remuneration, whether it be gender, race, religion, or factors other than performance, experience, education, knowledge, and size/scope of the role

Market position and benchmarking Xero's aim is to remunerate close to the market median for employees who are fully competent in their roles and above median for consistently high performers and key talent. This applies to both fixed and variable remuneration components.

Xero's policy on setting remuneration is based on a combination of market pricing and individual value to Xero. This involves evaluating employees' roles and matching them to an appropriate market role, whilst taking into account the role and the employee's experience, education, and knowledge. We then partner with local and global remuneration data providers to obtain the most relevant IT-industry market data.

Fixed remuneration The fixed remuneration of Xero employees is based on individual skills, experience, and performance. Fixed remuneration is reviewed on an annual basis and where appropriate is adjusted based on these

factors.

Short term incentives Xero's short term incentive (STI) plan rewards Xero's Leadership Team and senior management for achievement of objectives that are linked to Xero's strategy. STI is a cash amount that is calculated as a percentage of an employee's annual salary, which is based on the seniority of the role they perform and their country of residence.

The STI is measured against Xero's group financial targets and personal objectives. Xero's financial targets are approved by the P&R Committee and are aligned with the strategic objectives of Xero. Payments are calculated and processed after the end of each half-year period (or the full-year for selected executives), based on achievement against the STI measures.

Xero does not currently have deferral or clawback mechanisms in relation to performance based remuneration. However, as at 27 April 2018, this position is under review for executive roles and certain senior management roles.

Long term incentive Xero's long term incentive (LTI) employee share plan is a time-based retention plan that provides all employees with the opportunity to be rewarded with equity that is allocated annually and vests in equal portions over a three-year period subject to the individual remaining employed by Xero. The value of the annual allocation is calculated as a percentage of an employee's fixed salary and based on the seniority of the role they perform and their country of residence.

The LTI plan has been established to assist in the reward and retention of all employees and to align the interests of employees with shareholders by providing them with equity in Xero.

In addition, Xero's leadership team and certain senior management roles have been granted options under plans approved by the Board. These options also provide a time-based retention incentive, and generally vest in equal portions over four years.

Xero has a Securities Trading Policy that is available on Xero's website. This policy provides that employees and directors are prohibited from entering into a transaction that is intended to limit the economic risk of unvested or restricted Xero securities.

Non-executive director remuneration The Board sets the fees for the non-executive directors at a level that provides Xero with the ability to attract and retain directors of a high calibre. Directors have the option to receive their fees in cash or Xero shares. The fees paid to directors are structured to reflect time commitment, responsibilities, and workloads, as well as the country the director resides in. To preserve independence and impartiality, non-executive directors do not receive any performance related or "at risk" compensation. Xero does not provide any scheme for retirement benefits, other than statutory superannuation, for non-executive directors.

The annual total aggregate non-executive directors' remuneration pool is capped at NZD\$1.4 million.

For the details of the total remuneration of, and value of other benefits received by the non-executive directors for the reporting period, please refer to page 82 of this Annual Report.

DISCLOSURES

All financial figures in this section of the Annual Report are in New Zealand dollars except where indicated otherwise. Group means Xero Limited and its subsidiaries.

ENTRIES RECORDED IN THE INTERESTS REGISTER

Xero maintains an interests register in accordance with the Companies Act 1993 (New Zealand). The following are particulars of entries made in the interests register for the period 1 April 2017 to 31 March 2018.

Directors' interests

Directors disclosed the following relevant interests, or cessations of interest, in the following entities during the year ended 31 March 2018.

Director/Entity	Relationship	Director/Entity	Relationship
Craig Elliott¹		Graham Smith	
Pertino, Inc.	ceased to be a director	Splunk, Inc.	decreased minority shareholding
Lee Hatton		MINDBODY, Inc.	increased minority shareholding
BLD Group Pty Ltd. (The Executive connection)	director	Bill Veghte	
Susan Peterson		SurveyMonkey Inc.	ceased to be a director
ASB Bank Limited	director		
The New Zealand Merino Company Limited	ceased to be a director		

1. Craig Elliott resigned as a director effective 12 July 2017

Insurance

In accordance with the Companies Act 1993 (New Zealand), Xero has continued to insure its directors and officers (through renewal of its D&O insurance policy) against potential liability or costs incurred in any proceeding, except to the extent prohibited by law.

Share dealings of directors

Directors disclosed the following acquisitions or disposals of relevant interests in Xero shares during the year ended 31 March 2018.

Shares	Date of acquisition/disposal	Consideration per share	Number of shares acquired/(disposed)
Givia Pty Limited (Craig Winkler) ¹	15 May 2017	\$22.63	(3,000,000)
Lee Hatton	10 August 2017	\$26.46	2,078
Susan Peterson	22 August 2017	\$26.80	562
Bill Veghte	22 August 2017	\$26.80	4,491
Bill Veghte ²	26 September 2017	N/A	N/A
Craig Elliott	19 - 26 October 2017	\$33.54 ³	(12,000)
Craig Elliott	25 - 30 October 2017	\$33.46 ³	(8,000)
Craig Elliott	13 - 20 November 2017	\$31.98 ³	(20,000)
Rod Drury ⁴	17 November 2017	\$31.50	(3,000,000)
Craig Elliott	17 - 24 November 2017	\$33.25 ³	(35,000)

1. Shares are held by Givia Pty Limited, the trustee of an Australian charitable trust. Craig Winkler is a director of Givia Pty Limited; he and his family members are not beneficiaries of the trust

2. 14,204 shares were transferred from National Financial Services LLC on behalf of the Bean Brook Farm 2013 Annuity Trust to Bill Veghte. Bill Veghte is the trustee

3. Craig Elliott resigned as a director effective 12 July 2017. Consideration per share is disclosed as a weighted average price

4. Shares are held by Rodanna Ventures Trust. Rodney Kenneth Drury, Anna Margaret Clare Drury, and Scott Moran are the trustees

Lee Hatton, Susan Peterson, and Bill Veghte each received the above shares as part or full payment for their role as a director of Xero.

Holdings of shares and options by directors

At 31 March 2018	Number of shares	Number of options
Rod Drury ¹	17,719,779	-
Craig Elliott ²	25,000	-
Lee Hatton ³	12,301	-
Susan Peterson	562	-
Graham Smith	-	-
Bill Veghte ⁴	45,812	55,260
Craig Winkler ⁵	14,475,990	-

1. Shares are held by Rodanna Ventures Trust. Rodney Kenneth Drury, Anna Margaret Clare Drury, and Scott Moran are the trustees

2. Craig Elliott resigned as a director effective 12 July 2017. The number of shares is at 27 November 2017, the date Craig Elliott last disclosed a change in his Xero holdings. The shares are held by Private Nominees Limited as custodian for the benefit of Craig Elliott

3. In addition to the 12,301 shares held by Lee Hatton, 200 shares are held by Lee Hatton's spouse

4. 45,416 of the options held by Bill Veghte have vested (meaning that they are capable of being exercised). None of the options have been exercised as at 27 April 2018. 27,117 shares are held by National Financial Services LLC on behalf of Bean Brook Farm 2013 Annuity Trust. Bill Veghte is the trustee of the trust. 18,695 shares are held directly by Bill Veghte

5. 14,454,545 shares are held by Givia Pty Limited, the trustee of an Australian charitable trust. Craig Winkler is a director of Givia Pty Limited; he and his family members are not beneficiaries of the trust. 21,445 shares are held by Bangarie Investments Pty Limited. Craig Winkler is a director of Bangarie Investments Pty Limited

REMUNERATION REPORTING

Xero's remuneration policy and practices are summarised on pages 79-80 of this Annual Report.

Non-executive director (NED) remuneration The total remuneration¹ of, and the value of other benefits received by, each director during the year ended 31 March was:

Director	Country	Role	Committee Chair	2018 Director Fees (\$000s)	2018 Committee Chair Fees (\$000)	2018 Total Fees (\$000)	2017 Total Fees ² (\$000)
Rod Drury ³	New Zealand	executive director	-	-	-	-	-
Craig Elliott ⁴	New Zealand	Independent NED	-	25	-	25	57
Lee Hatton	Australia	Independent NED	ARM Committee	90	20	110	81
Susan Peterson	New Zealand	Independent NED	-	90	-	90	9
Graham Smith	United States	Independent NED	Chair, Nominations Committee	310	-	310	220
Bill Veghte ⁵	United States	Independent NED	P&R Committee	287	14	301	185
Craig Winkler	Australia	NED	-	90	-	90	57
Total				892	34	926¹	N/A⁶

1. Total remuneration is presented based on accounting expense and may include amounts earned but not yet received

2. Includes director and Committee Chair fees for the year ended 31 March 2017

3. Rod Drury was an executive director during the years ended 31 March 2018 and 2017, and received executive remuneration from Xero. He did not participate in Xero's share-based compensation plans nor did he receive remuneration in his capacity as director during those years

4. Craig Elliott resigned as a director effective 12 July 2017

5. The fees for Bill Veghte differ from the standard annual fees because they include accounting expense that has been recognised for options that continue to vest from option grants made to Bill Veghte in 2016 and 2015

6. Total remuneration for the year ended 31 March 2017 is not a meaningful comparison due to resignation of previous directors during that year

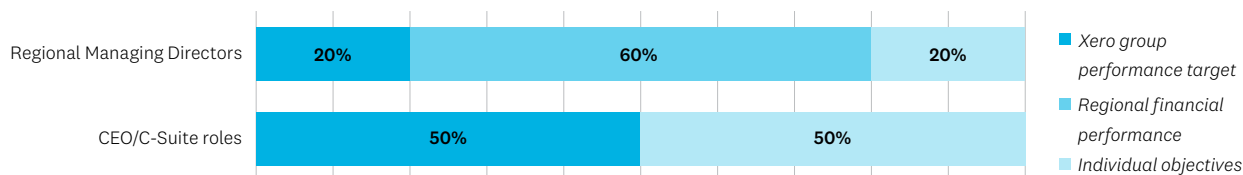
The total remuneration available to non-executive directors is fixed by shareholders. The annual total aggregate non-executive directors' remuneration pool is capped at \$1.4 million, which was approved by shareholders at the Annual General Meeting in July 2017.

The standard annual fees payable to non-executive directors during the year ended 31 March 2018 were as follows. Due to the global composition of the Xero Board, fees are determined by the Board by assessing local benchmarks in each director's country of residence, and are then annually converted to a New Zealand dollar rate:

Country of Residence	Chair (\$000s)	Director (\$000s)	Audit & Risk Management (ARM) Committee Chair (\$000s)	People & Remuneration (P&R) Committee Chair ¹ (\$000s)
New Zealand	180	90	20	15
Australia	180	90	20	15
United States	310	226	21	14
United Kingdom	260	115	19	19

1. No additional fees are currently paid for Chair of the Nominations Committee

Executive remuneration Xero's leadership team remuneration structure for the year ended 31 March 2018 has the fixed, STI and LTI components outlined on pages 79 and 80 of this Annual Report. The group financial targets for the executives' STI component for the year were net cash flow, revenue and ARPU (average revenue per user). The weighting of the STI component between the group financial performance, regional financial performance, and individual objectives for the year was:



The remuneration framework for Xero's leadership team and selected senior management roles, including STI and LTI structures, is under comprehensive review as at 27 April 2018.

CEO remuneration Details of the remuneration structure of the CEO (Rod Drury) for the year ended 31 March 2018 was as follows. Rod Drury does not participate in Xero's share-based compensation plans.

Salary (\$000s)	Target Short Term Incentive (\$000s)
550	275

The CEO's actual achievement against the target STI amount was 82.81% based on the following targets:

1. Financial results component - 50% of the target STI and consisting of the following measures:

- Net cash flow
- Revenue
- Annual Revenue Per User (ARPU)

2. Personal component - 50% of the target STI and consisting of the following measures:

- EBITDA
- Gross margin
- Succession planning
- Leadership metrics: diversity, attrition, engagement

Employee remuneration The following table shows the number of employees of the Group whose remuneration and benefits for the year ended 31 March 2018 were within the specified bands above \$100,000. The numbers below include 435 New Zealand-based current and former employees and 566 overseas-based current and former employees.

Remuneration including share-based compensation	2018 Number of employees	Remuneration including share-based compensation	2018 Number of employees
100,000 to 109,999	146	410,000 to 419,999	1
110,000 to 119,999	126	420,000 to 429,999	3
120,000 to 129,999	106	440,000 to 449,999	1
130,000 to 139,999	95	450,000 to 459,999	1
140,000 to 149,999	75	460,000 to 469,999	1
150,000 to 159,999	78	470,000 to 479,999	1
160,000 to 169,999	54	480,000 to 489,999	1
170,000 to 179,999	46	490,000 to 499,999	1
180,000 to 189,999	41	500,000 to 509,999	2
190,000 to 199,999	27	510,000 to 519,999	2
200,000 to 209,999	20	550,000 to 559,999	1
210,000 to 219,999	22	570,000 to 579,999	2
220,000 to 229,999	25	600,000 to 609,999	1
230,000 to 239,999	18	610,000 to 619,999	1
240,000 to 249,999	15	630,000 to 639,999	1
250,000 to 259,999	13	640,000 to 649,999	2
260,000 to 269,999	8	670,000 to 679,999	1
270,000 to 279,999	11	680,000 to 689,999	1
280,000 to 289,999	9	690,000 to 699,999	1
290,000 to 299,999	4	700,000 to 709,999	1
300,000 to 309,999	4	710,000 to 719,999	1
310,000 to 319,999	5	740,000 to 749,999	1
330,000 to 339,999	4	750,000 to 759,999	1
340,000 to 349,999	1	770,000 to 779,999	2
350,000 to 359,999	2	890,000 to 899,999	1
360,000 to 369,999	1	980,000 to 989,999	1
370,000 to 379,999	2	1,010,000 to 1,019,999	1
380,000 to 389,999	1	1,090,000 to 1,099,999	1
390,000 to 399,999	1	1,960,000 to 1,969,999	1
400,000 to 409,999	4	2,310,000 to 2,319,999	1

The remuneration covered in the table includes monetary payments received and share-based payments (i.e. restricted shares, restricted stock units, and vested and unvested options).

The table above includes the remuneration received by Rod Drury (\$779,000).

SHAREHOLDER INFORMATION

Issued capital The total number of issued ordinary shares in Xero Limited at 31 March 2018 was 138,449,071 and at 27 April 2018 was 138,608,659. At 27 April 2018, 608,614, ordinary shares are held on a restricted basis in connection with Xero's share-based compensation plans.

Distribution of shareholding (at 27 April 2018)

Range	Number of holders	%	Ordinary shares	%
1 to 1,000	15,099	79.83	4,806,157	3.47
1,001 to 5,000	3,112	16.45	6,644,346	4.79
5,001 to 10,000	371	1.96	2,656,697	1.92
10,001 to 100,000	290	1.53	6,936,086	5.00
100,001 and over	44	0.23	117,565,373	84.82
Total	18,916	100.00	138,608,659	100.00

There were 249 shareholders on Xero's share register holding less than a marketable parcel of shares (defined in the ASX Listing Rules as a parcel of not less than AUD\$500), based on the closing price of Xero's shares on the ASX on 27 April 2018, being AUD\$38.10.

RSUs and options At 31 March 2018, there were 43 individuals holding a total of 2,225,133 unlisted options and 323 individuals holding a total of 401,337 restricted stock units (RSUs). At 27 April 2018, there were 41 individuals holding a total of 2,097,348 unlisted options and 317 individuals holding a total of 258,568 RSUs. RSUs are a conditional contractual right to be issued an equivalent number of ordinary shares in Xero.

Substantial holdings and limitations on the acquisition of securities Xero has a sole listing on the Australian Securities Exchange (ASX), but remains a New Zealand incorporated and domiciled company. From a regulatory perspective, this means that while the ASX Listing Rules will apply to Xero, certain provisions of the Australian Corporations Act 2001 (Cth) will not. Xero is not subject to chapters 6, 6A, 6B, and 6C of the Australian Corporations Act 2001 (Cth) dealing with the acquisition of its shares (including substantial holdings and takeovers). The Companies Act 1993 (New Zealand) will continue to apply to Xero, while certain provisions of the Financial Markets Conduct Act 2013 (New Zealand) will not.

Therefore, there is no requirement on Xero's substantial shareholders to provide substantial holder notices to Xero. Where, however, Xero has received such notices during the year ended 31 March 2018, the most recent notice is detailed:

Substantial holder	Date of most recent notice received by Xero	Ordinary shares in which a relevant interest is held
Matrix Capital Management Company, LP and Matrix Capital Management Master Fund, LP	27 April 2017	11,767,306
Givia Pty Limited and Bangarie Investments Pty Limited (Craig Winkler)	16 May 2017	14,475,990
Anna Margaret Clare Drury and Rodney Kenneth Drury and Scott Moran (Rod Drury)	17 November 2017	17,719,779

Key limitations on the acquisition of shares in Xero are imposed by the following New Zealand legislation: Commerce Act 1986, Overseas Investment Act 2005 and Takeovers Act 1993, together with various regulations and codes promulgated under such legislation.

Top 20 holders The 20 largest holders of ordinary shares (as shown on the register on 27 April 2018) held 111,375,236 shares, equal to 80.35% of the total issued capital.

Shareholder rank and name	Ordinary shares	% of total issued capital
1. HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	18,904,915	13.64
2. ANNA MARGARET CLARE DRURY & RODNEY KENNETH DRURY & SCOTT MORAN	17,719,779	12.78
3. GIVIA PTY LIMITED	14,454,545	10.43
4. J P MORGAN NOMINEES AUSTRALIA LIMITED	13,615,024	9.82
5. HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED-GSCO ECA	9,281,003	6.70
6. CITICORP NOMINEES PTY LIMITED	8,440,179	6.09
7. AP INVESTMENTS (HK) LIMITED	6,643,636	4.79
8. HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED - A/C 2	5,037,090	3.63
9. NATIONAL NOMINEES LIMITED	4,112,580	2.97
10. JBWERE (NZ) NOMINEES LIMITED	2,465,895	1.78
11. CUSTODIAL SERVICES LIMITED	1,646,272	1.19
12. CITICORP NOMINEES PTY LIMITED	1,527,554	1.10
13. JASMINE INVESTMENT HOLDINGS LIMITED	1,500,000	1.08
14. NELSON NIEN SHENG WANG & PEI-CHUN KO	1,150,288	0.83
15. NICOLA JANE WILSON & DAVID JONATHAN WILSON	1,076,225	0.78
16. BNP PARIBAS NOMINEES PTY LTD	1,060,342	0.76
17. BNP PARIBAS NOMS PTY LTD	829,211	0.60
18. UBS NOMINEES PTY LTD	702,084	0.51
19. XERO LIMITED (EMPLOYEE RESTRICTED SHARE PLAN)	608,614	0.44
20. AUSTRALIAN FOUNDATION INVESTMENT COMPANY LIMITED	600,000	0.43
Total	111,375,236	80.35
Balance on register	27,233,423	19.65
Grand total	138,608,659	100.00

Voting rights Where voting at a meeting of shareholders is by voice or a show of hands, every shareholder present in person, or by representative, has one vote. On a poll, every shareholder present in person, or by representative, has one vote for each fully paid ordinary share in Xero.

On-market buy-back At the date of this Annual Report (10 May 2018), there is no on-market buy-back for Xero's shares.

COMPANY INFORMATION

Xero's sole listing on the ASX Xero has had a sole listing on the ASX since 5 February 2018, and is no longer listed on the New Zealand Stock Exchange (NZX). From the commencement of trading on 11 December 2017, the ASX admission category of Xero changed from "ASX Foreign Exempt Listing" to "ASX Listing" under ASX Listing Rule 18.9. Xero was delisted and its ordinary shares ceased to be quoted by the NZX from the close of business on 2 February 2018.

Donations The Group made no donations during the year ended 31 March 2018.

Company subsidiaries and directors Xero has 10 wholly-owned subsidiaries, consisting of an operating subsidiary in each of Xero's four core markets (being Australia, New Zealand, the United Kingdom, and the United States), Monchilla, Inc., Xero (Singapore) Pte. Ltd., Xero South Africa (Pty) Ltd, Xero Software (Canada) Ltd, Xero (HK) Limited, and a subsidiary that acts as trustee in relation to one of Xero's share-based compensation plans.

The following people held office as directors of subsidiary companies at 31 March 2018:

Xero (UK) Limited – Rod Drury, Gary Turner
Xero Australia Pty Limited – Rod Drury, Trent Innes
Xero (NZ) Limited – Rod Drury, Anna Curzon
Xero, Inc. – Rod Drury
Xero Trustee Limited – Rod Drury
Monchilla, Inc. – Rod Drury
Xero (Singapore) Pte. Ltd – Rod Drury, Alex Campbell
Xero South Africa (Pty) Ltd – Rod Drury, Gary Turner
Xero Software (Canada) Ltd – Rod Drury, Keri Gohman
Xero (HK) Limited – Rod Drury, Alex Campbell

No director of a subsidiary receives any remuneration or other benefits from Xero for acting as such.

During the year ended 31 March 2018:

- Keri Gohman became an advisor to FinTech Collective
- Trent Innes ceased as a director of Vault Intelligence LTD

Annual General Meeting Xero's AGM will be held on Thursday, 16 August 2018 at 2pm (AEST) 4pm (NZST) in Sydney, Australia, and virtually through an online platform provided by Xero's share registrar, Link Market Services Limited.

CORPORATE DIRECTORY

REGISTERED OFFICES:

NEW ZEALAND

19-23 TARANAKI STREET
TE ARO, WELLINGTON 6011
NEW ZEALAND
TELEPHONE: +64 4 819 4800

AUSTRALIA

1/6 ELIZABETH STREET
HAWTHORN, VIC 3122
AUSTRALIA
TELEPHONE: +61 3 9981 0408

COMPANY NUMBERS:

183 0488 NEW ZEALAND
ARBN 160 661 183 AUSTRALIA

WEB ADDRESS:

WWW.XERO.COM

DIRECTORS:

GRAHAM SMITH (*CHAIR*)
ROD DRURY
LEE HATTON
DALE MURRAY, CBE
SUSAN PETERSON
BILL VEGHTE
CRAIG WINKLER

LEADERSHIP TEAM:

STEVE VAMOS
(*CHIEF EXECUTIVE OFFICER*)

ANNA CURZON
(*CHIEF PARTNER OFFICER*)

KIRSTY GODFREY-BILLY
(*CHIEF ACCOUNTING OFFICER*)

SANKAR NARAYAN
(*CHIEF OPERATING AND FINANCIAL
OFFICER*)

RACHAEL POWELL
(*CHIEF CUSTOMER AND PEOPLE
OFFICER*)

TONY STEWART
(*CHIEF PRODUCT, PLATFORM AND
DATA OFFICER*)

KERI GOHMAN
(*PRESIDENT, AMERICAS*)

CRAIG HUDSON
(*COUNTRY MANAGER, NEW ZEALAND
AND PACIFIC ISLANDS*)

TRENT INNES
(*MANAGING DIRECTOR, AUSTRALIA
AND ASIA*)

GARY TURNER
(*MANAGING DIRECTOR, UNITED
KINGDOM AND EMEA*)

COMPANY SECRETARY:

CHAMAN SIDHU

AUDITOR:

ERNST & YOUNG

STOCK EXCHANGE:

XERO'S ORDINARY SHARES ARE
LISTED ON THE ASX

SHARE REGISTRAR:

LINK MARKET SERVICES LIMITED
LEVEL 13, TOWER 4, 727 COLLINS
STREET
MELBOURNE, VIC 3000
TELEPHONE: +61 3 9067 2005

ANNUAL MEETING:

DATE: 16 AUGUST 2018
TIME: 2PM (AEST), 4PM (NZST)
LOCATION: SYDNEY, AUSTRALIA

