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Xero Chairman's Address for Special Shareholders' Meeting

14 May 2009

I am delighted to be addressing shareholders at this Special Shareholders' Meeting.

We are here to consider the resolution that was outlined in the Notice of Special Meeting; in summary that the Board be authorised to issue 20 million new ordinary shares in Xero to Craig Winkler and parties associated with him for a consideration of 0.90 cents per share.

Given the proposed investment by Craig Winkler and his associates will result in them owning more than 20% of the shares in Xero, their investment is subject to shareholder approval under both the NZX Listing Rules and the Takeovers Code. That is why we are here today.

As most of you are aware, Xero listed on the New Zealand Stock Exchange on 5 June 2007, raising NZ\$15 million at NZ\$1.00 per share. From the date of listing until 7 April 2009 (the date on which we announced our strategic placement to the market), the volume weighted average price of Xero shares was approximately NZ\$0.88 per share; a trading performance the Board considers particularly satisfactory given the significant decline in the share price of many companies over the past year.

Since listing, Xero has managed its costs in accordance with its plan and has proven its business model. Our announcement on 7 April 2009 of the Fundraising followed announcements of the achievement of a significant growth in customer numbers and a major strategic partnership with Telstra in Australia.

On 31 March 2009, we announced that Xero had passed the 6,000 customer number milestone, double the customer figure at December 2008 and on 1 April 2009, we announced that the Company had entered into a strategic partnership with Telstra in Australia. In addition, we announced on 16 March 2009 the appointment of Andy Lark as our US-based advisor. Andy is a New Zealander who has lived in the US for many years and is currently a Senior VP of Global Marketing for Dell Computer. In his advisory role, he will provide the Board and the executive team with guidance related to our planned US market entry.

More recent announcements include Xero's winning of two Webby Awards – the "Oscars of the Internet" (6 May 2009). The international Webby Awards are considered to be the most respected benchmarks of success in the Internet world and Xero's wins are affirmation that its software design is world-class.

On 11 May 2009, we announced that Xero has signed a strategic partnership with British Telecom. This is a very significant development for the Company and will see BT marketing Xero as a co-branded offering to its very large (1.7 million) SME customer base throughout the United Kingdom. This will start in July 2009.

Xero now has strategic partnerships with the major telecommunications carriers in New Zealand, Australia and the UK, which not only provides the Company with very significant channel capability in three geographies but also the opportunity to enhance its brand presence in all regions through these associations.



These telco partnerships, like the host-to-host data connection and marketing partnerships now established with all major New Zealand banks and most of the major Australian banks, require a significant amount of time and business development effort to secure. They are an important investment in Xero's future and a critical component of the Company's strategy of building a world-class software business from New Zealand. They are also testament to the skills of those in our senior management team responsible for consummating these deals and validates our strategy of investing in top people who can operate globally.

Today, we announced our preliminary audited financial results for the full year ended 31 March 2009. Highlights include:

- Operating revenue from customers of NZ\$959,000 (2008: NZ\$134,000)
- Operating expenses of NZ\$8,364,000 (2008: NZ\$5,488,000)
- Net loss before tax of NZ\$6,751,000 (2008: NZ\$4,310,000)
- Staff headcount at 31 March 2009 of 55 (2008: 44)

These results are consistent with the Company's plan and advice previously provided to the market. Further commentary on our 2009 results will be made at the Company's Annual Meeting in July 2009.

The announcement of our financial results today also included a statement that as at 10 May 2009, Xero had secured 7,500 paying customers, approximately 3,000 of which are in the UK.

These customers have been acquired in exactly two years. Our IPO offer document was issued on 11 May 2007 and in the twelve months following its issuance we secured 1,400 customers. By 31 December 2008, the customer count had grown to 3,000, only to double to 6,000 at 31 March 2009. Another 1,500 customers have been added in the six weeks to 10 May 2009, bringing the total at that date to 7,500.

The Board is very pleased with the progress Xero has made during the last twelve months. We have:

- Delivered on the initial milestones set out in our IPO Prospectus
- Developed a world-class online accounting platform
- Developed a strong, symbiotic channel and support relationship with the accounting community in New Zealand
- Established beachhead presences in Australia and the UK; presences that are now set to be leveraged
- Developed a number of key strategic relationships with banks and telecommunications carriers
- Built a network of software companies wishing to connect their software to Xero and co-market their products with ours
- Continued to develop our team of talented people and, particularly, our development staff
- Created a foundation for continued strong customer growth

The Board believes that Xero is well positioned in the current tough economic conditions. Almost all small businesses require an increased focus on cashflow and timely financial information and the provision of this information in a simple, convenient and easy to use form is what Xero is ideally suited to do.



Xero's success is also contributing to the creation of new jobs and the generation of export revenues and we are proud to be able play our part in the economic recovery that is so badly needed.

Xero is now poised for further growth. The raising of new capital will enable the Company to push further ahead in the UK and Australian markets and enter the US market. Our market release on 7 April 2009 included the announcement of NZ\$5.2m of funding from other strategic shareholders, including the Bank of New Zealand, two of Xero's Directors, Graham Shaw and Sam Morgan, and a well-known institutional shareholder. This component of the Fundraising did not require shareholder approval and shares have already been issued to these shareholders.

We are grateful to the new and existing shareholders that participated in this strategic placement and look forward to your ongoing support.

As shareholders you will also be aware that the Company is running a Share Purchase Plan which enables all New Zealand-based shareholders to purchase up to \$5,000 of Xero shares at \$NZ0.90 cents, the same price as the placement shares.

We felt that it was important to offer as many shareholders as possible the opportunity to participate in the capital raising on the same basis as those strategic investors that participated in the placements.

The Board and its advisors considered various fundraising alternatives for Xero to raise growth capital, against a backdrop of volatile and uncertain global capital markets.

The fundraising options considered included raising capital from strategic investors and the possibility of a rights issue to all existing Xero shareholders.

The Board concluded that a rights issue was unlikely to raise the amount of capital required to fund Xero's growth opportunities and would not provide the strategic benefits which a placement to the BNZ and Craig Winkler was able to offer. In addition, a rights issue would most likely have been priced at a significant discount when compared to the Fundraising price of NZ\$0.90 per share, given the volatile global capital market environment. A rights issue would also have taken significantly longer to conclude with an uncertain outcome for shareholders and the business generally.

The Board, therefore, concluded that a Fundraising from strategic investors was in the best interests of all Xero shareholders, given:

- it provides sufficient capital to enable Xero to accelerate its international growth;
- it provides Xero with access to strategic capabilities, including the considerable experience of Craig Winkler in the small business accounting software and services market. This will assist in the further development and execution of the Company's strategy;
- it has strengthened the shareholder base by adding an institutional shareholder;
- the capital has been raised from a group of knowledgeable and informed shareholders at a price of NZ\$0.90 per share, which is above the VWAP share price of NZ\$0.88 since the time Xero listed. The Fundraising price is also above the Xero VWAP share price of NZ\$0.86 over the 5 trading days prior to our announcement, on 2 April 2009, of a potential capital raising; and
- Xero will be well funded with a strong balance sheet, which will help to instil customer confidence and accelerate the development of additional strategic partnerships in Xero's international markets.



As with all fundraisings, it is only with a lot of detailed work that success in closing the transaction is assured. In our case, we were fortunate to have a great team of advisors help us through the process and I would like to express my appreciation to:

- Rob Cameron, Ross Christie and Stephen Kaiser from Cameron Partners who provided investment banking services, often working extended hours to achieve deadlines.
- Dean Oppenhuis and Amon Nunns from Bell Gully, our legal advisors, who also worked long hours when this was necessary.
- Alan Dent and Linda Meade from Deloitte for completing the Independent Adviser's Report against a tight timeline.
- Linda Cox, our Company Secretary, for her guidance and expertise on compliance and NZX Listing Rule matters.
- Paul Williams, our General Manager Finance, on whose shoulders fell much of the responsibility for the financial analysis connected with the placements.
- Marcelle Ashcroft and her team from Link Market Services, our Share Registrars, for handling the production and distribution of the shareholder information packs for the placements and the SPP.
- My fellow Directors for their continued oversight of and input to the financing transactions.

I would also like to thank Craig Winkler and his financial advisor, Marcus Fletcher, for the positive and responsive way in which they engaged in our negotiations. We think this augers well for the future of our working relationship with Craig.

As many shareholders may have anticipated, I would like to advise that if the resolution before you today is passed, that it is the Board's intention to invite Craig Winkler to join the Board upon completion of the Fundraising. We believe that his experience and insight will be very beneficial to the Board and the executive team and help generate value for all shareholders.