



NOTICE OF SPECIAL MEETING OF SHAREHOLDERS

Notice is given that a Special Meeting of the shareholders of Xero Limited (the Company) will be held at NZX Centre, Level 2, 11 Cable Street, Wellington on Thursday 14 May 2009, commencing at 4.00pm.

SPECIAL BUSINESS

Resolution: Issue of 20,000,000 Ordinary Shares – Ordinary Resolution

To consider and, if thought fit, to pass the following ordinary resolution:

“That the board of directors of the Company (the Board) is authorised to:

(a) *issue 20,000,000 ordinary shares in the Company (the Placement Shares) in the following proportions:*

- (i) *19,500,000 Placement Shares to Andrew Craig Winkler or any vehicle or entity controlled by Andrew Craig Winkler and/or his spouse or any charitable trust or family trust established by Andrew Craig Winkler;*
- (ii) *333,333 Placement Shares to Binalong Rural Pty Limited; and*
- (iii) *166,667 Placement Shares to Mordes Howard Pty Limited,*

for consideration of \$0.90 per Placement Share, such Placement Shares when issued, to rank equally with all existing ordinary shares of the Company; and

(b) *take all action, do all things and execute all documents and agreements necessary or considered by them to be expedient to give effect to such transactions.”*

Linda Cox
Company Secretary
Wellington
30 April 2009

NOTES

PROXIES

All shareholders are entitled to attend and vote at the meeting or to appoint a proxy (who need not be a shareholder of the Company) or corporate representative (in the case of a corporate shareholder) to attend and vote on their behalf. If you wish, you may appoint 'The Chairman of the Meeting' as your proxy or as an alternative to your named proxy.

A proxy form is enclosed with this notice.

The notice appointing a proxy or representative must be received by 4.00pm on Tuesday 12 May 2009 at the offices of the Company's registrar:

*Link Market Services Limited
Level 16, Brookfields House
19 Victoria Street West
Auckland (PO Box Bag 91976, Auckland 1142)
Telephone: +64 9 375 5998
Fax: +64 9 375 5990*

VOTING RESTRICTIONS

The investors Andrew Craig Winkler and his associated interests, Binalong Rural Pty Limited and Mordes Howard Pty Limited (the *Investors*) and their associates (within the meaning given to such term under the Takeovers Code) must not vote on the resolution in this Notice of Special Meeting under rule 7(d) of the Takeovers Code. In addition, the Investors and their Associated Persons (within the meaning given to such term under the NZSX Listing Rules) will be excluded from voting in favour of, or voting discretionary proxies in favour of, the resolution in this Notice of Special Meeting under NZSX Listing Rule 9.3.1.

INVITATION

At the conclusion of the meeting on 14 May 2009, light refreshments will be served and Directors look forward to the opportunity of meeting informally with shareholders.

SPECIAL MEETING – EXPLANATORY NOTES

The explanatory notes set out the details of the transactions which are the subject of the resolution and the approval required by the shareholders of the Company under the NZSX Listing Rules (the *Listing Rules*), the Companies Act 1993 (the *Companies Act*), the constitution of the Company (the *Constitution*) and the Takeovers Code Approval Order 2000 (the *Takeovers Code*).

INDEPENDENT ADVISER'S REPORT

Accompanying this Notice of Special Meeting is an Independent Adviser's Report from Deloitte, which has been prepared in accordance with the requirements of the Takeovers Code. It provides further information about the merits of the proposed allotments to the Investors having regard to the interests of those persons who may vote to approve the allotment, comprising all of the shareholders of the Company.

RESOLUTION: ISSUE OF 20,000,000 ORDINARY SHARES

The Company seeks approval of its shareholders, for the purposes of Listing Rule 7.3.1 and Rule 7(d) of the Takeovers Code, to issue 20,000,000 ordinary shares in the Company to the Investors for an issue price of NZ\$0.90 per Placement Share.

The shareholder approval being sought at the special meeting relates only to the issue of ordinary shares to the Investors. The private placement of 5,777,779 ordinary shares to other investors, including the Bank of New Zealand and the directors of the Company Sam Morgan and Graham Shaw, as announced by the Company on 7 April 2009, took place in accordance with Listing Rule 7.3.5 and that transaction has been completed and the shares issued.

TERMS AND CONDITIONS OF THE ISSUE

- *Number of securities to be issued:* 20,000,000 ordinary shares.
- *Purpose of the issue:* to provide funding to enable the Company to accelerate its international growth opportunities in the United Kingdom, Australian and US markets.
- *The issue price:* NZ\$0.90 per ordinary share.
- *Time for payment:* upon issue of the Placement Shares.
- *The parties to whom the Securities are to be issued:*
 - 19,500,000 Placement Shares to Andrew Craig Winkler and his associated interests;
 - 333,333 Placement Shares to Binalong Rural Pty Limited, an entity associated with Marcus Fletcher, an associate of Andrew Craig Winkler; and
 - 166,667 Placement Shares to Mordes Howard Pty Limited, an entity associated with Jack Mordes, an associate of Andrew Craig Winkler.
- *Consideration received for the issue:* the Placement Shares are to be issued in accordance with a subscription agreement entered into between the Company and the Investors for aggregate consideration of NZ\$18,000,000 (the Subscription Agreement).
- *The period when the issue will be made:* expected to be on or about 21 May 2009.
- *The ranking of securities to be issued for any future benefit:* the Placement Shares will be fully paid ordinary voting shares in the Company and will rank equally in all respects with all existing ordinary shares in the Company.
- *Restriction on sale of Placement Shares:* the Investors have agreed that they will not sell or transfer any Placement Shares for a period of twelve months following the date of the Subscription Agreement and have agreed to enter into embargo deeds with the Company accordingly.

The Directors believe that undertaking the capital raising by way of a private placement of new shares is preferable to other alternative means of raising capital for the following reasons:

- The private placement allows capital to be raised from strategic investors.
- The board of directors concluded that a rights issue was unlikely to raise the amount of capital required to fund its growth opportunities.
- A rights issue would most likely have been priced at a significant discount when compared to the private placement price of NZ\$0.90 per share.
- A rights issue would also have taken significantly longer to conclude with an uncertain outcome for Xero's shareholders and the business generally.
- Existing Xero shareholders are still being given an opportunity to increase their own investment in the Company at the same price as the Investors through the Company's Share Purchase Plan, details of which were announced to the market on 15 April 2009.

The Board believes that the proposed issue price of NZ\$0.90 per Placement Share to be issued pursuant to this resolution is fair and reasonable to the Company and its existing shareholders.

DILUTION EFFECT ON CURRENT SHAREHOLDERS

The total number of ordinary shares on issue will be 81,238,472 following the issue of 20,000,000 Placement Shares to the Investors. The issue of the Placement Shares will have the effect of diluting current shareholders' percentage holding in the Company by a ratio of 1:0.754. For example, if a shareholder held shares equal to 10% of all voting securities before the issue of the Placement Shares, their shareholding would equal 7.54% of all voting securities after the issue of the Placement Shares. However, this dilution is in percentage shareholding terms and does not reflect the increased assets and prospects of the Company following the issue of the Placement Shares.

REQUIREMENT FOR RESOLUTION

Listing Rule 7.3.1

Listing Rule 7.3.1 provides that shareholder approval must be obtained for any issue of shares, unless the issue falls within one of a number of exceptions. One of the exceptions is Listing Rule 7.3.5 which allows placements of shares by an issuer up to a maximum, in any 12 months, of 20% of the total number of shares on issue at the commencement of that 12 month period. In this case, the private placement of 20,000,000 Placement Shares constitutes an issue of approximately 32.66% of the total number of shares on issue immediately prior to the allotment of the Placement Shares (which will result in Andrew Craig Winkler and his associated interests holding 24.6% of the total number of shares on issue immediately after the allotment) and is therefore greater than the threshold under the Listing Rule 7.3.5 placement exception. Accordingly, shareholder approval of the precise terms and conditions of the proposal to issue the Placement Shares is being sought in accordance with Listing Rule 7.3.1.

Companies Act and Constitution

Section 42 of the Companies Act permits the board of directors of a company to issue shares at any time, to any person and in any number it thinks fit, subject to the Companies Act and the constitution of the company. Clause 4.1 of the Constitution provides that the Board may issue shares to any person and in any number it thinks fit provided that the issue is made in compliance with the Listing Rules.

Takeovers Code

Under Rule 6 of the Takeovers Code, a person who holds or controls:

- (a) no voting rights, or less than 20% of the voting rights, in a code company may not become the holder or controller of an increased percentage of the voting rights in the code company unless, after that event, that person and the person's associates hold or control not more than 20% of the voting rights in the code company; or
- (b) 20% or more of the voting rights in a code company may not become a holder or controller of an increased percentage of the voting rights in the code company.

There are a number of exceptions to this rule. These include where a person becomes the holder or controller of voting rights in a code company by acquisition or allotment of shares that have been approved by an ordinary resolution pursuant to Rule 7(d) of the Takeovers Code.

The Company is a code company as it is party to a listing agreement with a registered exchange, being NZX.

As a result of the proposed allotment of Placement Shares under the Subscription Agreement, the Investors will hold or control more than 20% of the voting rights in the Company. The Company considers that the Investors are associated for the purposes of the Takeovers Code. Accordingly, such allotment requires approval in accordance with rule 7(d) of the Takeovers Code. If shareholders approve the Resolution, then they are approving the issue of the Placement Shares to the Investors for the purposes of rule 7(d) of the Takeovers Code.

The information required under Rule 16 of the Takeovers Code is set out at Appendix 1 of this Notice of Special Meeting.

Independent Adviser's Report

As required by rule 18 of the Takeovers Code, the Company has commissioned an Independent Adviser's Report on the issue of the Placement Shares pursuant to the Subscription Agreement.

The Independent Adviser's Report is required by the Takeovers Code because, as a result of the allotment of the Placement Shares, the Investors will hold or control more than 20% of the voting rights in the Company. The Takeovers Code requires that, where shareholders are being asked to give their approval under rule 7(d) of the Takeovers Code, the directors must obtain a report from an independent adviser on the merits of the proposed allotment having regard to the interests of those persons who may vote to approve the allotment, comprising all of the shareholders of the Company.

Deloitte has prepared the Independent Adviser's Report and a copy of that report is attached to this Notice of Special Meeting as Appendix 2.

BOARD RECOMMENDATION

The directors of the Company unanimously recommend that shareholders vote in favour of the issue and allotment of the Placement Shares to the Investors.

MEANING OF AN ORDINARY RESOLUTION

An ordinary resolution of the Company means a resolution approved by 50 percent or more of the votes of those shareholders entitled to vote and voting on the resolution.

NZX APPROVAL

NZX Limited has approved this Notice of Special Meeting.

APPENDIX 1 – INFORMATION REQUIRED BY RULE 16 OF THE TAKEOVERS CODE

- (a) Andrew Craig Winkler and his associated interests, Binalong Rural Pty Limited and Mordes Howard Pty Limited (the Investors), are the proposed allottees. Binalong Rural Pty Limited is an entity associated with Marcus Fletcher, an associate of Andrew Craig Winkler. Mordes Howard Pty Limited is an entity associated with Jack Mordes, an associate of Andrew Craig Winkler.
- (b) Particulars of the securities to be allotted are:
- (i) The number of ordinary shares to be allotted to the Investors pursuant to the Subscription Agreement is 20,000,000 (the Allotment). The shares are to be allotted in the following proportions:
 - 19,500,000 ordinary shares to Andrew Craig Winkler and his associated interests;
 - 333,333 ordinary shares to Binalong Rural Pty Limited; and
 - 166,667 ordinary shares to Mordes Howard Pty Limited.
 - (ii) Following the Allotment, the total number of shares on issue will be 81,238,472. The percentage of the aggregate of all existing voting securities and all voting securities being allotted to the Investors after completion of the Allotment represents 24.62%.
 - (iii) The percentage of all voting securities that will be held or controlled by each of the Investors, after completion of the Allotment, is:
 - Andrew Craig Winkler and his associated interests will hold 24.0%;
 - Binalong Rural Pty Limited will hold 0.41%; and
 - Mordes Howard Pty Limited will hold 0.21%.
 - (iv) The aggregate of the percentages of all voting securities that will be held or controlled by the Investors with their associates, after completion of the Allotment, is 24.62%.
- (c) Not applicable. The Placement Shares are voting securities of the Company which is a code company.
- (d) The issue price for the allotment will be NZ\$0.90 per share, which is payable upon the issue of the Placement Shares expected to be on or about 21 May 2009.
- (e) The reasons the Company is issuing and allotting the Placement Shares to the Investors are as follows:
- The placement will provide sufficient capital to enable the Company to accelerate its international growth opportunities.
 - The Company has raised capital from a group of knowledgeable and informed investors (including the Investors) at a price of NZ\$0.90 per share, which is above the Company's volume average weighted share price of NZ\$0.88 between the time the Company listed on the NZSX and 2 April 2009, the date the Company announced the potential capital raising. The price is also above the Company's volume average weighted share price of NZ\$0.86 over the five trading days prior to the Company's announcement on 2 April 2009.
 - The Company 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 the Company's international markets.
- (f) The Allotments under the resolution, if approved, will be permitted under rule 7(d) of the Takeovers Code as an exception to rule 6 of the Takeovers Code.
- (g) The following statement has been provided by each of the Investors:
- “Apart from the terms of the Subscription Agreement and Embargo Deeds, there are no agreements or arrangements (whether legally enforceable or not) that have been, or are intended to be, entered into between me and any other person relating to the allotment, holding, or controlling of the voting securities to be allotted, or to the exercise of voting rights in the Company.”*
- (h) The report from an independent adviser that complies with rule 18 of the Takeovers Code is set out in Appendix 2 to this Notice of Special Meeting.

(i) The Directors make the following statement for the purposes of rule 19 of the Takeovers Code.

The directors of the Company are pleased to unanimously recommend approval of the allotment of the Placement Shares under rule 7(d) of the Takeovers Code. The directors' reasons for recommending this approval are as follows:

- The placement provides sufficient capital to enable Xero to accelerate its international growth opportunities;*
- The placement has raised capital from a group of knowledgeable and informed investors (including the Investors) at a price of NZ\$0.90 per share, which is above the Company's volume weighted average share price of NZ\$0.88 between the time the Company listed on the NZSX and 2 April 2009, the date the Company announced the potential capital raising. The price is also above the Company's volume weighted average share price of NZ\$0.86 over the five trading days prior to Xero's announcement on 2 April 2009; and*
- The Company 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 the Company's international markets.*

APPENDIX 2 - INDEPENDENT ADVISER'S REPORT TO SHAREHOLDERS

Please find Appendix 2 enclosed separately.