



MARKET RELEASE

Xero Chairman's Address for 2009 Annual Meeting

23 July 2009

Customer numbers

I am delighted to begin my address to the 2009 Annual Meeting by reporting that Xero has passed the 10,000 customer mark.

This Company was established on the premise that it has the potential to serve tens of thousands of small business customers internationally and to hit this milestone just two years after listing is proof we are delivering on what we said we would do.

It has been a year of great significance for Xero. The business has developed rapidly as we built out our online accounting software platform, added customers at an accelerating rate, secured a number of key strategic partnerships, deepened our relationship with the accounting community in New Zealand and successfully established beachhead operations in Australia and the United Kingdom.

10,000 paying customers is a ten-fold increase in our customer numbers since March 2008 and, in aggregate, these 10,000 customers generate approximately \$330,000 of committed monthly revenues.

At our current monthly cost levels break-even for Xero is, therefore, around 30,000 customers.

The accelerating growth in customer numbers reflects Xero's focus on customer acquisition and the average revenue received from each customer. This is the fundamental driver of value in a subscription-based Software as a Service (SaaS) business like Xero.

Growth in the United Kingdom has been particularly strong and we now have more than 4,000 customers in this key market.

Poised for global growth

More than half of Xero's committed revenues are now earned offshore. This progression from a reliance on the domestic market is significant, and is a strong affirmation that we are on our way to fulfilling the goal we have always had of building a global software business from New Zealand.

In the midst of a world economic recession Xero is pleased to be able to play a part in the recovery by creating new jobs and generating export earnings.

Marketing partnerships

Our international growth strategy will see Xero continue to develop strategic partnerships with telecommunications carriers and banks. These relationships provide Xero with important and substantial distribution channels as well as marketing leverage. They also complement our accounting firm channels, which are principally focused on support and service.

Over the last year, we have secured marketing partnerships with Telecom New Zealand, Telstra in Australia and British Telecom in the United Kingdom. Marketing activity with British Telecom and Telstra started this month and we are ramping up resources in the UK and Australia to capitalise on this.

The partnership with British Telecom provides access to BT's 1.7 million small business customers through its business applications portal, while Telstra's Software as a Service platform, T-Suite, makes Xero available to 700,000 Australian small business customers.

United Kingdom

In the United Kingdom, we have appointed Gary Turner as UK Managing Director. Gary is a 20-year veteran of the accounting software industry and joins us from Microsoft where he has been UK Product Group Director for Microsoft's Dynamics ERP and CRM product families. Prior to his role with Microsoft, Gary was Managing Director of Pegasus Software, a well-known UK vendor of small business accounting software.

We undertook an extensive search to find a person suitable to take over the helm of the UK operation from Xero Co-founder, Hamish Edwards, and we are delighted to have appointed someone of Gary's calibre. Gary will join us in August.

Hamish has established a very sound business in the United Kingdom and I would like to thank him for this huge effort and his never-ending enthusiasm. Hamish returned to New Zealand last week and is here with us today. He will now concentrate on driving global accounting partnerships.

Australia

In Australia, we have just completed a road show through Sydney, Melbourne and Brisbane where our team gave presentations to accountants and their practice staff about making the switch to online accounting. From the feedback received, it would be fair to say the Australian accountants present at these events left impressed with Xero's capabilities and its ability to integrate with other applications such as payroll.

We have also just recruited two key sales people to join our customer care teams in Sydney and Melbourne. The focus in Australia is to rapidly accelerate customer growth, leveraging our partnership with Telstra, while also building strong relationships with the accounting community.

Product growth

Our product offering has continued to broaden in 2009 with new releases going live approximately every month. We now have four country-specific versions of Xero – New Zealand, Australia, UK and Global.

In June, we released our most significant product enhancement to date – multi-currency. This smoothly integrated solution took thousands of hours to build and perfect and converts up to 160 currencies in real time, with foreign exchange rates updated hourly.

This release has generated excellent feedback – especially from our UK customers who work in both Pounds and Euros. We believe our multi-currency capability places Xero ahead of the pack in terms of the functionality offered by the incumbent providers of small business software and demonstrates that we are re-defining accounting for the SME sector by providing our customers access to sophisticated features that have not previously been available to this market.

Future product development will see Xero move from a purely "back office" accounting application to include "front office" services, thus increasing average revenue per user (ARPU) and overall revenues.

Financial result

Our financial result was consistent with our plan.

We have managed costs tightly and will continue to do so, even as we expand globally. Our break-even point is still in the future and we will manage the business to achieve break-even as quickly as we can, but as long-term value is established by having a large customer base, we will continue to invest in building that base, but do so mindful of the need to balance long-term value creation against the achievement of near-term break-even status.

Capital raising

In recent months, Xero has raised a total of \$29 million in new capital through a combination of strategic placements and a Share Purchase Plan. The placements included \$5.2 million from a number of investors including the Bank of New Zealand, two of Xero's Directors, Sam Morgan and Graham Shaw, and an institutional investor. This capital raising followed a cornerstone \$18 million investment by Founder and ex CEO of MYOB, Craig Winkler, and parties associated with him.

Craig is no longer involved with MYOB, which is Xero's key competitor in the Australasian market. His financial contribution is a strong endorsement of Xero and his experience and domain knowledge will be invaluable to us.

Craig joined our Board in May.

Also in May, Xero offered a Share Purchase Plan to its existing New Zealand-based shareholders, raising a further \$5.8 million. The Share Purchase Plan allowed our shareholders the opportunity to participate in Xero's capital raising on the same terms as those that contributed to the strategic placements. Approximately 70 percent of our shareholders elected to subscribe for additional shares through the Share Placement Plan, which for us was a very pleasing result.

The \$29 million of new capital will enable Xero to accelerate its Australian and UK market entry activities, in so doing leveraging the investment already made in establishing beachhead presences in both regions, and allow the Company to enter the US market earlier than we would have otherwise been able to.

Importantly, the new capital also strengthens our balance sheet and, as a result, will help instil customer confidence and accelerate the development of additional strategic partnerships in key international markets.

Share buy-back

One of Xero's key challenges is to ensure we attract and retain staff of the highest calibre. With this in mind, last year the Board put in place an Employee Share Plan. The share plan is a component of the remuneration of all Xero employees and ensures that their interests are aligned with the interests of shareholders. Details of the Employee Share Plan are set out in the 2009 Annual Report.

This morning, the Board decided that a share buy-back would be undertaken to meet the requirements of this year's employee share allocations, rather than issuing further new shares. To give some guidance, we anticipate acquiring approximately 500,000 shares on market.

A formal announcement as to when the buy-back will commence will be made in the near future.

US/Global

During the next twelve months we intend entering the US market. This market entry will require careful research, partnership development and some additional product tailoring. As you know, Andy Lark, a New Zealander who has lived in the United States for many years, and who is currently a Senior VP of Marketing for Dell Computer, has been appointed our US advisor.

Andy will provide guidance to the Xero Board and Management Team as we plan and execute this next step in our international expansion.

Conclusion

We are proud of what we have achieved in just two short years. We have a world-class software platform; robust, customer-focused operational support systems; a talented management team; and, now, the necessary funding in place to pursue the next phase of our journey.

Our journey is still far from finished but we remain confident that with the support of our customers, our partners, our staff and our shareholders that we will ultimately emerge as one of the leading global providers of online accounting software for small businesses.

In closing this address, I would like to express my thanks to our staff for their enormous and sustained commitment to the Company. I would also like to say to those shareholders here today how much we appreciate your support.

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