MARKET RELEASE
Chairman’s Address for 2011 Annual Meeting

21 July 2011

Once again, it is with great pleasure that I open Xero’s 2011 Annual Meeting following a year of continued rapid growth and achievement of key milestones. Xero is now a global leader in the online accounting software sector and has established itself as the principal challenger to the incumbent market participants – Intuit, MYOB and Sage.

The outlook for the year ahead is exciting and I will talk more about our plans in the latter part of this address, as will Rod Drury, Sam Morgan and Craig Winkler in a follow-on presentation designed to update shareholders on Xero’s strategy and some key initiatives.

Revenue and Customer Growth

Xero reported operating revenues for the 2011 financial year of $9.3 million. This represents a tripling of revenue earned in the 2010 financial year – the second consecutive year the Company has tripled its revenues.

During 2011, Xero’s paying customers, excluding Xero Personal customers, grew from 17,000 at 31 March 2010 to 36,000 at year-end and I am pleased to announce today that our paying customer count has increased to 45,000. This accelerating growth in our customer acquisition rate is occurring in all markets in which we operate and reflects the strength of our product offering, our unswerving customer focus in everything we do and the strength of our accounting partner and eco-system networks through which we take our software to market.

In February 2011, Xero exceeded $1.0 million in monthly revenue for the first time. As our customer count accelerates, the Company’s committed monthly revenue will grow strongly, providing us with an attractive annuity revenue stream from a relatively “sticky” base of small business customers. Today, Xero has customers in 100 countries – a strong endorsement of the quality and functionality of the software and the high level of acceptance of our online delivery model.

Xero has now established itself inside 2,500 accounting firms and continues to develop innovative features to gain broader adoption within the accounting community. A growing number of accounting practices now use Xero exclusively. This accountant channel provides access to hundreds of thousands of small business customers.

Xero is renowned for its product innovation and the Company continues to change the face of the accounting software market as it combines small business and accountant processing into a single, cloud-based solution – all delivered at a much lower cost than our competitors. The combination of product innovation, targeted marketing, best-in-class customer service and a global aspiration continues to underpin the Company’s strong growth.

Markets

Xero’s traction in its home market of New Zealand has been rapid with customer revenues for the year ended 31 March 2011 totalling $5.9 million. The Company now has a relationship with a majority of the accounting firms in New Zealand and through these firms is connected to thousands of small businesses. This success is being mirrored in Australia and the UK, giving us confidence that the approach is working.
Australian customer revenues have grown approximately five times from $283,000 in 2010 to $1.5 million this year and headcount has nearly doubled from 8 to 14. An Australian Head Office was established in Melbourne in October 2010 and a former senior Microsoft executive was appointed as Australian Managing Director shortly thereafter to take the business to the next level.

Revenues from Xero’s UK operation were $1.3 million, increasing three and a half times over 2010 revenues of $353,000. The UK business has suffered from a lack of direct bank feeds but with the launch of our Yodlee bank feed service in November 2010, interest in Xero from both the accountant and small business communities has heightened noticeably. Xero is now an established and recognised brand in the UK market.

Both the Australian and UK operations continue to gain momentum and are well positioned to grow their share of the market.

Xero is increasing its activities in the US market. We have just established an office in San Francisco, relocating some key staff from New Zealand and hiring locally in the US. The Company is building strategic partnerships and we have a number of marketing initiatives under way. The reception we have received so far has been extremely positive, which is a strong indicator that Xero can eventually capture a significant share of the vast US accounting software market.

Xero is leveraging its US Advisory Board, which includes Paypal founder and first outside Facebook investor, Peter Thiel. The Advisory Board’s network is proving invaluable and allows us to access market influencers and prospective strategic partners that we would not otherwise be able to reach.

**Product Development**

Xero has continued to extend the capability of its core software for small businesses and continues to add new features. To date, we have delivered over 60 new releases of the software, which by software industry standards is exceptional.

We have furthered the integration of Xero with data gathering service, Yodlee, and have extended direct bank feeds to the UK, the US and many other markets.

In the 12 months since Xero Personal was launched, the feature set has advanced over six software releases and the product continues to attract new customers and favourable media reviews.

The Xero solution partner eco-system has continued to grow strongly and there are now more than 40 publicly available online partner solutions that integrate seamlessly with our software and many more are in the process of integration. This focus on connectivity will be an important element of Xero’s US go-to-market strategy, as it will enable access to large numbers of users of complementary products.

An example of the effectiveness of this approach is our “Modern Practice” initiative, where working with Microsoft and a number of other software providers, Xero is core to an integrated suite of cloud-based solutions that allow accountants to run their entire practice without on-premise servers.

**Financial Result**

Operating revenue from customers was $9.3 million while operating expenses totalled $18.0 million. The net loss after tax was $7.5 million. These results are consistent with our expectations as we manage the investment in our existing business operations, while at the same time increasing our investment in the development of growth markets like the US. Ultimately, these new markets will create significant shareholder value.

During the year, the Company took the decision to change the rate at which it amortises its software. This was increased from three to four years, to three to five years to better reflect the period in which the capitalised development costs will generate future economic benefits. The impact of this change was a decrease in amortisation costs for the year of $880,000.

At year-end, Xero had cash reserves of $16.9 million.
The Year Ahead

Xero has succeeded in developing a truly innovative product. We have created beautiful software that is so easy to use that people enjoy doing their accounts, we have connected accountants, small businesses, banks and eco-system partners by leveraging the power of the Internet and we have created a durable business model by successfully monetising our software from the outset.

The small business market is one of the largest markets in the world and the opportunity for Xero to be the online accounting software provider of choice to this market globally is enormous. The Company has proven through its success to date that it can now leverage its technology leadership by also becoming the leading global player in its sector measured by customer count and revenues.

Achievement of this goal will require a continuing, and increased, commitment to growth. With this in mind, we have:

- Strengthened our management team with the addition of a CFO and two new General Managers.
- Increased the size of our development team to ensure that the product fit with each major regional market we target is an industry exemplar.
- Deepened our marketing capability, particularly our online marketing capability, so we can reach out to global markets. The US will be a focus of activity in the near-term.
- Established a US office in San Francisco and hired a Managing Director to lead the US-based team, which will include the Company’s CTO who will transfer to the US in August. This office will be resourced up as US demand for our software grows.

We have now established a very strong platform for growth, we have the capital we need to exploit the market opportunities available to us, we have deep domain knowledge and expertise, we have an extremely talented team of people, and we have a variety of go-to-market mechanisms in place that will rapidly scale.

These building blocks have been carefully put in place over the last four years and, as a consequence, much of the start-up risk associated with the Company is now eliminated. Xero is now moving from establishment phase to being a truly global software business based from New Zealand (which was our goal from the outset) and we intend pursuing our growth agenda at pace as we are confident that our disruptive software offering provides utility and commercial benefits to accountants and small business owners alike at a time when the world is transitioning from on-premise to online software delivery models.

In 2009, Xero provided market guidance that the Company would break-even at the end of this calendar year.

Given the size of the market opportunities available to the Company and the success Xero has achieved to date, the Board has decided that the continued pursuit of this growth agenda, and particularly the establishment of a strong US presence, is in the best interests of all shareholders. This is not a change to the Company’s core strategy as it allows the Board the flexibility to pursue options that will add shareholder value without being constrained by short-term profit guidance.

Shareholder value accretion will, ultimately, be a function of a very large customer base being monetised through a durable business model that delivers sound economic returns.

Rod Drury will provide more detail about our growth strategy in his presentation. Sam Morgan will also talk about the importance of monetisable business models and scale for technology businesses based on his experience at TradeMe and other companies in which he has invested.
Partnership with New Zealand Post

Today, we are pleased to be able to announce that Xero has concluded a partnering agreement with New Zealand Post that will see Xero and New Zealand Post working together to link our accounting software to Post’s new digital postal services.

Further details of this initiative will be announced by New Zealand Post shortly.

Acquisition of Paycycle

Since entering the Australian market, we have learned that a fully featured payroll product is a necessary complement to our core accounting software.

We have, therefore, today signed an agreement with one of our Australian payroll partners, Paycycle, to acquire its business for a consideration of AUD$1.5 million, comprised of AUD$500,000 in cash and AUD$1.0 million in Xero shares. Paycycle is based in Melbourne and has developed a cloud-based payroll product that is rapidly winning recognition with small businesses in Australia for its functionality, ease of use and seamless integration into Xero.

The acquisition of Paycycle will accelerate Xero’s penetration of the Australian market as it will remove an objection from prospective customers that our product is missing a component that many regard as part of a core accounting software offering. The acquisition also provides Xero with a small, specialist payroll development team at a time when it remains difficult to secure skilled software personnel.

Further information about this acquisition is available in a separate market release, which has been issued today.

Later on, Craig Winkler will discuss the need for a payroll product to be part of our core accounting software suite and background the rationale for this acquisition.

Summary

Xero has now completed its start-up phase and is poised for substantial, value accretive, international growth based on its innovative products, proven delivery capability and market approach.

The Company has a durable, directly monetisable and scalable business model that generates attractive annuity revenues streams from “sticky” customers.

The available small business software market is enormous and we will continue to take a “think big” approach as we develop our strategy and execution plans in order to capitalise on the competitive advantages we have already created within the business.

In closing, I would like to acknowledge the contribution of our truly world-class staff. We are extremely proud of their achievements to date and without them it would simply not be possible to achieve our ambitious future goals. I would also like to acknowledge the great support we get from our ever-increasing accounting and developer partner networks and, of course, say thanks to all our shareholders for their ongoing support of the Company.