MARKET RELEASE

Chairman’s Address 2010 Annual Meeting

22 July 2010

It is with great pleasure that I open Xero’s 2010 Annual Meeting after a year of rapid growth and an outlook that continues to be extremely positive. At last year’s Annual Meeting, we announced we had reached the 10,000 customer mark. I am pleased to be able to say that we now have in excess of 22,000 paying business customers - that’s an increase of 5,000, or just on 30%, since balance date. Xero really is starting to be considered a “mainstream” product and a world leader in terms of innovation in the online application space.

There is, however, so much potential still to be realised as we continue our journey, and the Xero team is on track to achieve further milestones in the 2011 financial year. This is something I shall revisit later, but first I would like to review and speak to the highlights of the year to 31 March 2010.

Revenue and customer growth

Xero reported operating revenues of just over $3.0 million in the 2010 financial year, tripling revenues for the previous year. At year-end, we had secured more than 17,000 paying customers from more than 50 countries. This compares to 6,000 customers in 25 countries at the end of 2009.

The strategy

Consolidation in our regional markets of New Zealand, Australia and the United Kingdom was a key focus for the period, as building a strong presence in these markets provides a strong platform from which to pursue growth globally. Our strategy has been to recruit and build the accountant channel in all these regional markets.

By encouraging accountants to set up their small business clients on Xero, they are not only able to see first hand how Xero benefits those clients, but how the software can help them grow their practices. As a result, the number of accounting firms using Xero increased to 980 during the period. Converting the client base of these accountants onto Xero has the potential to provide access to a very large customer pool.

Strategy execution

In order to recruit, grow and educate the accountant channel we have created country specific teams of dedicated sales staff, led by managers with extensive local experience. In particular, we have increased our investment in Australia and the United Kingdom as these markets develop. These teams are supported with innovative marketing and events-based programmes, which, together with our acclaimed online customer care, provides the platform for us to build a truly global software business from New Zealand.

Strategic partnerships

Xero continues to nurture and pursue strategic partnerships with telecommunications carriers and banks. Marketing partnerships with Telecom in New Zealand, Telstra in Australia and British Telecom in the United Kingdom play an important part in building the Xero brand and its global credibility. These partnerships also position us well for the next wave of mobile computing.
Most recently, Xero entered into an exclusive joint marketing agreement with ANZ Bank in Australia and Singapore. ANZ will work with Xero and its own online and direct sales channels to promote the benefits of Xero to its small business customers.

Connecting to the world

The agreements Xero has with major New Zealand banks, most major Australian banks and HSBC in the United Kingdom, that allow the daily automatic transfer of financial data, remain a key competitive advantage.

To extend this capability to new markets, Xero has partnered with United States-based Yodlee, Inc. – the world leader in online and mobile personal finance management and payments solutions. This is a significant development for Xero as it broadens our global reach to include connectivity with 11,000 global financial institutions and other account sources (including 100 throughout Australia).

In particular, the agreement with Yodlee accelerates Xero’s entry into the North American market.

Beyond accounting

Early in the 2009 financial year, Xero decided to enter the personal finance market. This adjacent market, which is growing very rapidly globally, leverages the Company’s core competencies in product development and its international reputation in software design.

Xero Personal was launched in late March this year in conjunction with the BNZ. A hybrid model that is believed to be a world first, it combines the strong innovation Xero customers have come to expect with the power of transactional banking platforms. The offering broadens Xero’s product appeal to a wider consumer market and further leverages the investment in our Xero platform.

Product development continues

From its inception in 2006 to the end of the 2010 financial year, Xero has delivered more than 45 software releases. This development regime is virtually unheard of among software vendors worldwide. Significant releases during the period included multi-currency with hourly exchange rate feeds.

Other development milestones included software connections to the products of SaaS (Software-as-a-Service) global leaders Salesforce.com (a CRM system vendor) and FreshBooks (an invoicing system vendor), both designed to garner interest in Xero in North America.

The growth in “Xero Network” partners, who offer solutions that connect electronically to Xero, rose dramatically from 13 to 35 during the year, including the addition of four payroll partners in Australia.

Xero also continued to win awards for its online software, including three ONYA’s (New Zealand Web awards) for Best Web Application, Best User Experience and Most Outstanding Website.

Financial result

Our financial result of a net loss of $8.45 million was better than planned. This was due to costs being tightly managed, whilst balancing the need to invest for the future. Xero continues to hold a strong cash position.

The Company remains on track to reach monthly break-even in the second half of the 2011 calendar year. We will continue to manage the business to reach this objective as quickly as possible, however, we remain mindful of the need to balance this with the creation of long-term value through investment in the development of our international markets.
North America

As mentioned earlier, our service agreement with Yodlee supports our intention to build a presence in large and strategic markets such as North America.

The North American market is complex and our strategy for entry is being carefully developed in conjunction with our US Advisor, Andy Lark. Poor execution would be very costly and thus we are approaching this market in a measured way, doing our homework thoroughly, making sure our product fits the market as well as possible, and ensuring that we can resource our go-to-market plan appropriately.

We already have several hundred small US businesses using the global version of Xero and the market reception to that product has been particularly positive. Widespread adoption of Xero in the US will, however, require us to offer a localised version, just as we have in our other major international markets of Australia and the United Kingdom, and work is already under way on this product.

We expect to be active in the North American market in the latter part of this financial year.

It’s all about scale

Looking to the future, we remain very optimistic about our international growth prospects and expect customer uptake and revenues to accelerate as the business is scaled up. We have developed our delivery and service models for scale from the outset and have invested in systems and processes that will serve us well at every level in the business, providing the foundation to support the uptake of significant numbers of new customers without any degradation in the customer care or responsiveness we are well known and respected for.

We have also invested in internationally experienced people to manage this scale up and feel confident that, based on their exemplary management of our growth to date, that they are world-class and well equipped to handle the challenges that lie ahead.

Xero’s partnership with Rackspace, our managed hosting provider, is also indicative of our mindset and early preparation for operating a business at scale. Rackspace is one of the world’s leading hosting and infrastructure providers to SaaS businesses and was chosen by Xero because of its capability to provide a superior level of service to our customers all around the globe.

Another key part of Xero’s strategy has been to have the capital to do things properly. This is why Xero listed in mid 2007 within a year of being founded, raising $15 million to establish the business and create its initial product suite, following which an additional $29 million was raised in a second round in April 2009 to fund the next expansion phase.

Team/investor effort

Building a global software company from New Zealand requires a mammoth effort, especially in these formative years. We could not do it without our talented staff, who are always willing to go the extra mile. I thank them all for what they have achieved and urge them to reflect on these achievements with well deserved pride.

I would also like to thank our shareholders. You are a vital part of this exciting journey and your support is greatly appreciated.

Final note

Tomorrow, we will be making a market announcement of a minor shareholding change in the Company and I felt that I should foreshadow that here this evening. Sam Morgan has reached an agreement with founders Rod Drury and Hamish Edwards as well as our COO, Alastair Grigg, to purchase approximately 1.4 million shares from them at a market price of $1.45 per share. This transaction is supported by the Company’s Board and we are delighted that Sam has chosen to increase his shareholding, which following the transfer will stand at 4.86%. Rod and Hamish do not intend to sell down any further shares prior to the Company achieving break-even.