Xero Chairman Phil Norman’s Presentation
Annual Meeting 2008

I am delighted to be addressing shareholders at this, our first Annual Meeting as a publicly listed company.

The first year of business following an IPO is a challenge for any company and in Xero’s case, given that we were still in start-up mode, we are very proud of what we have achieved. Indeed, very few companies have listed in New Zealand as early as we chose to.

We saw a public listing as an ideal way of securing the capital we required to develop a global software business from New Zealand. Being a public company, of course, has also provided an opportunity for New Zealand investors to participate in the growth of the Company and we were very pleased that approximately 1,200 people subscribed for shares when we listed on 5 June 2007.

During our first year of operations following the issue of the Company’s Offer Document on 11 May 2007, the Company exceeded its customer acquisition forecast, securing 1,406 customers. The forecast was 1,300. This was achieved while operating within our cost forecast, allowing us to finish the year with a better than forecast cash balance.

If anybody needs reminding, Xero develops and markets online accounting software for small businesses. The software is delivered over the Internet and licensed to users as a subscription service for a modest monthly fee.

This method of delivering software, referred to as Software as a Service or SaaS, is rapidly gaining momentum in all areas of the software industry and for small businesses, which are our target customers, it enables them to acquire software conveniently and at low cost, enjoying all the ease of use and security benefits of centrally hosted software.

Technology analyst IDC continues to up their forecast of the SaaS opportunity and currently predict in excess of 30% compound annual growth in the next five years across the entire SaaS industry. They also say that small business is the hot area for SaaS. We spotted this trend several years ago and by acting quickly we are particularly well positioned to ride this wave.

Development of a SaaS business requires a significant investment of capital up-front. This investment includes the development of software, the building of a highly scalable back office infrastructure (provisioning, billing, customer support, analytics, etc), a market development investment and a significant investment in people. However, once such businesses successfully transition through the establishment phase they should produce very attractive returns because
subscription revenues grow exponentially as customers are acquired, yet long-run costs do not track up in a linear relationship to revenues.

We believe that Xero has now successfully laid the foundations that will enable it to capture a significant share of the small business accounting market internationally and in so doing become a market leader.

Our growth strategy in the year ahead will be focused on geographic expansion, in particular the UK market where we already have a beachhead presence with both staff and customers, and Australia, a market we expect to enter in the very near future. Longer term, we will enter other markets but this is a journey that will take time and hard work – and we are doing it properly.

We will also continue to drive growth through the development of new software modules and add new features in the core accounting offering, for example, multi-currency capability. This expansion of the Xero product suite will push up the potential revenue available from each customer and grow our addressable market.

To achieve a global presence will require us to continue to have the best product in our category and we believe that today Xero is unquestionably the best online accounting product available anywhere. We have received numerous accolades and awards for the product, both here and internationally, and regularly update the software through a release programme that incorporates both customer feedback and best practice accounting and software design.

International success will also require us to forge partnerships of different kinds in all our markets. Key among these will be partnerships with the accounting community as they are the key source of endorsement in almost all small businesses’ purchases of accounting software. In addition, relationships with banks, telecommunications carriers, Internet service providers and similar organisations will also become increasingly important as we seek to leverage our resources in the most effective way possible.

An example of this is our marketing partnership that we have with the Bank of New Zealand. Some of the first initiatives in this partnership include a mail out to BNZ small business customers and promotion of Xero on the Bank’s Web site. And as a further endorsement, BNZ recently became our first partner to take a small shareholding on the Xero register.

Developing these relationships, particularly internationally, takes time but we believe that a partnering strategy is an essential part of Xero’s overall business strategy. The alternative approach of building a direct sales and marketing capability in each region we target would be very expensive and, ultimately, would not allow us to grow at the rate required to secure a significant share of each market.

Another form of partnership that we are developing is the “Xero Network”. This initiative recognises that Xero has the potential to become the accounting engine for a wide variety of industry applications and we expect to see an acceleration in collaborations from software companies looking to migrate their applications to the Web.

Notwithstanding the global nature of our business, we intend to maintain the Company’s development operation and most other core functions in New Zealand.
Xero has strong and long-established competitors in all of its geographic markets. The major competitors are publicly listed companies that have grown both organically and by acquisition. As a result, they have substantial customer bases and multiple product lines. There are also many small suppliers of accounting software, most of whom have a local or niche focus.

Xero has already become the primary challenger to the incumbent suppliers of accounting software in New Zealand, competing on the basis of a strong and different value proposition linked to its pioneering and easy-to-use Web-based product, its subscription-based business model and the Company’s ability to innovate more quickly than its larger competitors.

Xero has been well received in New Zealand by small businesses, the accounting profession, major trading banks (all of which now provide transaction data feeds directly into our software each day) and other software companies looking to integrate our accounting engine into their own applications. This is great market validation of our product suite and market approach and from our early work in the UK and Australia we are confident that our software will be equally well received in those markets. Users are looking for a simple online accounting application that can easily be used wherever they are and we believe that our timing in bringing such a product to market could not be better. Most of those making the switch to Xero have been using products that are now quite old and welcome the opportunity to move to a Web-based product that improves their productivity.

We are all, of course, conscious that business conditions worldwide are currently tough and that small businesses will be affected by the downturn. The requirement for small businesses to produce accounts will not, however, change and we believe that our monthly subscription model and the easy-to-use cash management features of Xero will attract small business owners to Xero in these tighter economic times.

The accelerating interest in SaaS applications is an industry trend that remains extremely positive for Xero and we are well positioned to benefit from this trend as subscription-based offerings require a much lower initial financial commitment than a more traditional licence purchase does.

The Company’s Directors are very pleased with what has been achieved during this first year of business as a public company. We consider that we have created a platform for substantial international growth in the years ahead and also consider that the market opportunity in front of Xero is enormous.

During the next few months we will be finalising our business plans for the UK and Australia, both of which will have an impact on the rate at which we burn cash. Conservation of our cash reserves will continue to remain an important priority for Directors and Management and every effort will be made to drive the Company to a cash positive position as soon as practicable.

Xero’s success has been accomplished through the dedicated efforts of a multi-disciplined team of 50 staff, all of whom have performed at the highest level. I would like to publicly acknowledge that commitment and effort and thank them all.

I should also acknowledge the advice and guidance we have received from all our external advisors, particularly as we set about becoming a publicly listed company while so young.

Finally, I would like to express our appreciation to all our shareholders who have supported us so well. We are looking forward to our continuing association.