Xero Limited
2017 Annual Report

xero

Contents

Cover Image – InHouse Design // Xero customer
Inside Image – Kokako Cafe // Xero customer

Highlights

1,035,000

Subscribers at 31 March 2017

77%

Gross margin for the year

52%

Reduction in EBITDA loss from $(59.9) million to $(28.6) million

$295.4 million

Total operating revenue for year | 43% growth

$359.7 million

Annualised committed monthly revenue at 31 March 2017

$2.196 billion

Total lifetime value of the subscriber base at 31 March 2017

Chair and Chief Executive's Report

Dear shareholder,

It has been a year full of milestones for Xero, including surpassing one million subscribers and completing our move to Amazon Web Services (AWS). We have extended our market-leading position in Australia, New Zealand, and the United Kingdom, and continued to grow our presence in North America, South East Asia, and South Africa.

The small business opportunity is growing and its success is increasingly more important for the overall prosperity and health of the world. Economic trade between small businesses builds common ground between people around the world. As an industry leader, we have a responsibility to actively support and encourage small business growth.

THE GLOBAL SMALL BUSINESS PLATFORM

With more than one million subscribers, over 100,000 business advisors and 500+ connected apps, Xero has established a global ecosystem to help millions of small businesses around the world as we forge ahead with our global growth strategy.

The move to AWS, layered under the $1.4 trillion worth of incoming and outgoing transactions recorded across the Xero platform in the past 12 months, uniquely positions us to leverage machine learning, automation and artificial intelligence advances. We're starting to put all this data to work for our small business owners and accounting advisors to harness the power of our network, unlocking productivity in new ways.

Our unique global platform enables small businesses and their advisors to expand their operations offshore, connect to banks in multiple countries and use Xero's technology partnerships with Google, Apple, Square, Paypal, Stripe and others to do business seamlessly all over the world. Working with more than 110 financial institutions, these relationships help us rewire the ways small businesses connect.

OPERATIONAL EXCELLENCE AND EXECUTION

Operating revenue continues to climb, enabling us to continue our investments. We are in a good position where we are still building value for the future, while cash outflows reduce. Xero is managing the business to cash flow break-even within its current cash balance. Operating metrics are expected to improve in FY18 as Xero drives efficiencies through automation and economies of scale.

We have built a world-class team aligned with our mission to use cloud technology to rewire the global small business economy. Our organisational structure has evolved, leveraging the management capability within our operating geographies, and combined with a clear strategy, provides capacity for future stages of growth. We are ramping up efforts in markets where we see a substantial amount of opportunity as small businesses and the accounting industry transition to the cloud.

Thank you to our customers, team, and shareholders for your continued support as Xero forges ahead on our journey toward $1 billion in revenue and beyond.

Graham Smith
Chair

Rod Drury
Chief Executive

Business Update

Overview

Driving strong outcomes, Xero continues to deliver year-on-year growth with improved operating metrics. We're executing a clear strategy focused on investing for long-term growth while driving operational improvements across the business.

Building a world-class team, our leadership structure has evolved and operating rhythms are now well established so teams have the resources to execute on our mission.

Product innovation continues to be at the heart of everything we do. Finalising the migration to AWS enables us to build on top of the $1.4 trillion worth of incoming and outgoing transactions recorded across the Xero platform in the past 12 months, using advanced machine learning automation and artificial intelligence technologies.

Strong execution in core markets has seen us add 318,000 subscribers to pass one million subscribers across 180+ countries.

Proving that the Xero model is replicable in new markets, we're working to expand the services offered and regions served to help unlock small business productivity and widen Xero's global market opportunity.

Operational excellence*

As the cloud accounting market leader outside the U.S., Xero is unique in building a global business on a single platform. The business has focused on making disciplined investments in product and distribution channels while delivering another period of predictable growth in revenue and subscribers.

Xero has a proven growth engine based on our product leadership, and a global distribution network of accountants, bookkeepers, and cloud integrators. We also have a vibrant ecosystem which already connects millions of people and businesses globally.

Product innovation, targeted marketing, and our accounting partners are core to Xero's customer acquisition strategy. With more than 100,000 business advisors and counting, we grow as those advisors transition their new and existing client bases to Xero.

Xero had a year full of milestones, achieving operating cash flow break-even in the second half of the year, surpassing one million subscribers, and completing our migration to AWS. EBITDA, excluding share-based payments, turned positive in the second half of the financial year while overall EBITDA margin improved significantly during the year.

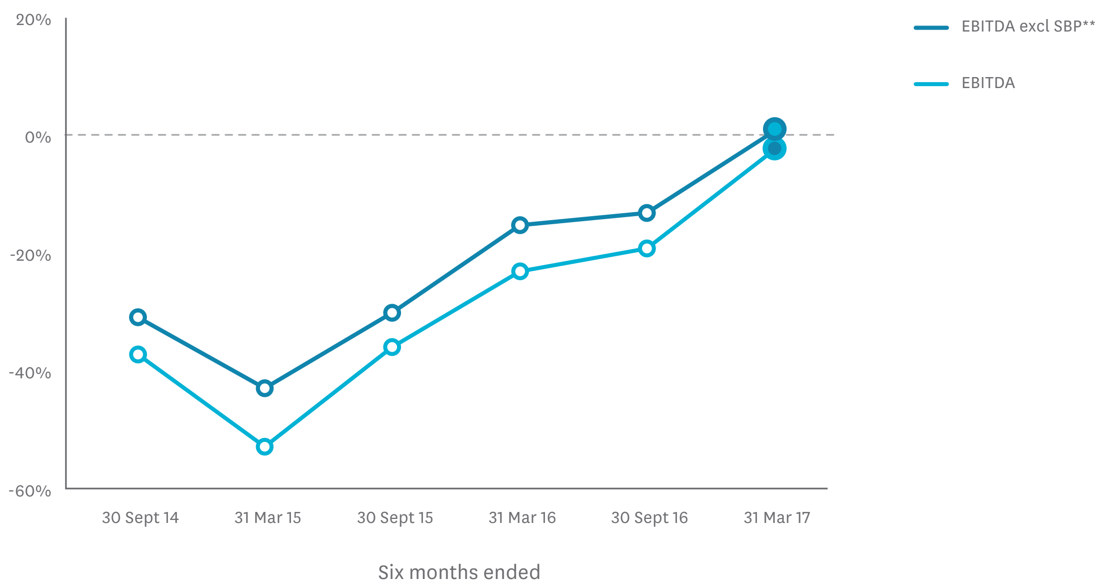
Operating revenue grew by 43% year-on-year to $295.4 million, an increase of $88.3 million. Constant currency operating revenue growth was higher at 51%.

Execution across the business has expanded total lifetime value from $1.5 billion at the start of the year, to $2.2 billion at 31 March 2017. Economies of scale and advanced automation processes, particularly across sales and service channels, have also seen gross margin improve by 10 percentage points in three years, even with the costs of migrating the platform in the year.

During the year, Xero added more than $100 million to annualised committed monthly revenue (ACMR), reaching $359.7 million, an increase of 39% over the prior year. ACMR growth in constant currency was 45% year-on-year.

Xero improved cash flow performance through the year, with operating and investing cash outflows reducing 20% on the prior year. Xero is managing the business to cash flow break-even within its current cash balance. Operating metrics are expected to improve in FY18 as Xero drives efficiencies through automation and economies of scale.

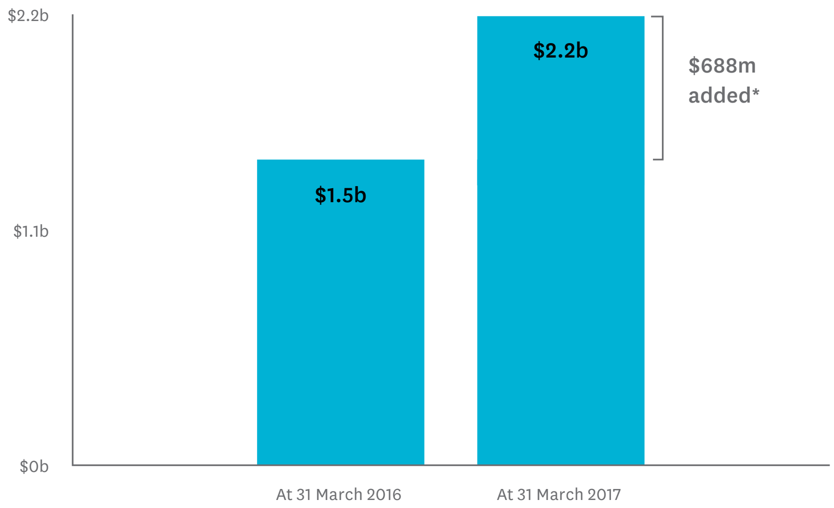
EBITDA AS A PERCENTAGE OF OPERATING REVENUE



***Share-based payments (SBP) are a non-cash cost to Xero*

**See the Management Commentary for further explanation of the terms used in this section*

TOTAL GROUP SUBSCRIBER LIFETIME VALUE (LTV)



*Added in the 12 months to 31 March 2017

Doing the best work of our lives

From humble beginnings sitting around the kitchen table in a small apartment in New Zealand, to serving more than one million subscribers in 180+ countries today, our success is thanks to our business advisors, 500+ app partners, our shareholders who gave us the resources to build a vibrant global community, and a team of people at Xero doing the best work of our lives.

Xero is recognised as a values-driven organisation that places the customer at the centre of everything we do. Our flat and globally distributed leadership structure provides the agility and discipline required to deliver sustained and efficient growth.

Operating rhythms are now well established internally so teams have the resources, streamlined structures, and processes in place to execute and deliver strong results which improves incremental value to the business. Building a world-class team of more than 1,700 people and establishing ourselves as a global platform are key aspects of our success.

Innovative product

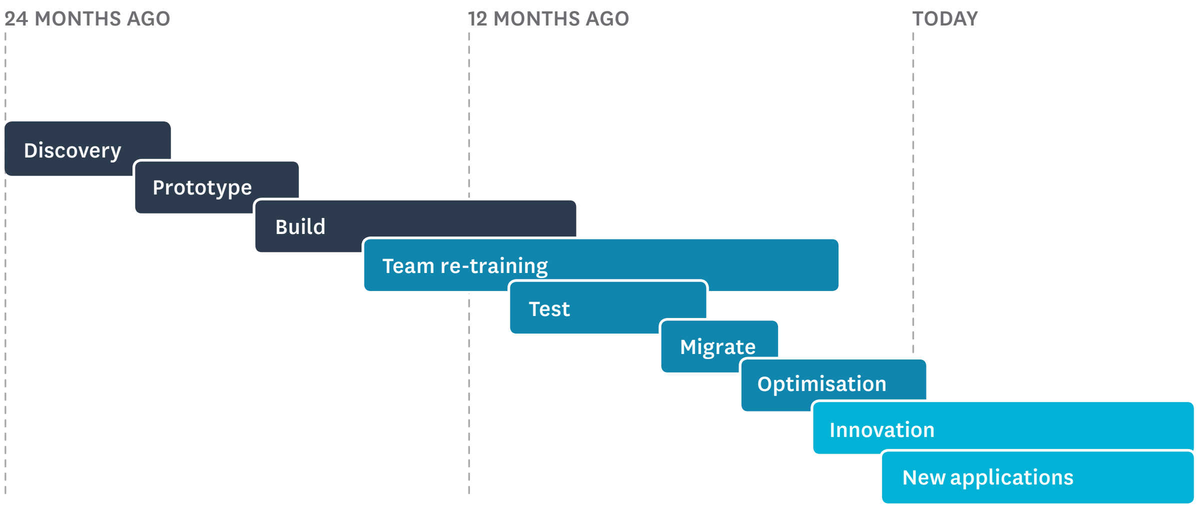
Over the past 12 months, Xero's pace of innovation has again shifted up a gear with more than 1,500 feature and product updates released. Some highlights include multiple strategic partnership integrations, a streamlined experience for pension auto-enrolment in the United Kingdom, payroll functionality now in more than 35 U.S. states, and invoice reminders to help boost small business cash flow.

AWS MIGRATION

Xero completed the migration of 1.4 petabytes of data and 59 billion records to set up our AWS platform. In March 2017, we had more than three petabytes of data on AWS and used 4,800 servers.

With the considerable investment AWS has made in platform services, we can now build and deploy software in shorter delivery timeframes than those that haven't yet moved to a public cloud platform or are still running multiple code bases.

XERO'S NEXT PHASE OF INNOVATION, ENABLED BY THE AWS MIGRATION, IS INTENDED TO SUPPORT MARKET EXPANSION



ACCOUNTING IS IDEAL FOR MACHINE LEARNING

ACCESS TO VAST AMOUNTS OF TRAINING DATA

HIGH VALUE DOMAIN

A CLEARLY DEFINED TARGET STRUCTURE

MANY SCENARIOS TO APPLY MACHINE LEARNING

A LEADER IN MACHINE LEARNING, ARTIFICIAL INTELLIGENCE, AND AUTOMATION

The cloud transformed accounting. Machine learning and automation will transform it again. During this year, Xero released an industry-first, personalised automation system for small business cloud accounting.

The automation will mean small businesses no longer need to worry about where their invoices are coded and evolves with the processes used by the business and their advisor. When the small business owner creates their next invoice, Xero automatically suggests the account code, so they don't inadvertently make a mistake.

The new technology is the first step in Xero's plan to build a bespoke, personalised assistant for small businesses and their advisors, cutting administrative burden and preventing mistakes enabling them to spend more time growing their business.

Xero's Find & Recode is an instance where our vast data set has been leveraged to extract insights about the patterns of small business owners. Analysing the data, we could see more than three million re-coded transactions and clear patterns of errors made by small business owners that their advisors had to fix. For our daily bank reconciliation – we processed more than 250 million lines in March 2017 alone – we can now correctly code nine out of 10 transactions.

NEXT GENERATION TECHNOLOGY TOOLS FOR 100,000+ BUSINESS ADVISORS

Built in consultation with Xero's global network of advisors, Xero's enhanced Partner Program brings together millions of dollars of investment in new tools to connect small businesses with advisors.

The Xero Partner Program, which includes benefits such as the Advisor Directory, education, practice tools and new levels of reward recognition, is designed to boost the success rate of business advisors and small business owners by connecting them to advice and services that make a difference. Xero connects more accountants and bookkeepers to small businesses than any other platform, with 89% of Xero subscribers connecting to an advisor.

Xero HQ, the open practice platform, was also launched during the year. It provides advisors with intelligent insights and relevant alerts to prioritise work using the activity feed, drill into clients with the Explorer feature, and streamline reporting with new report templates. Through the new connected app experience, advisors will also soon be able to choose from a range of apps, giving them flexibility to simply manage and grow their practices.

We will continue to invest in innovation and build the capability of our product team, while delivering updates at a rapid cadence. This enables us to expand our competitive advantage, add additional revenue streams, and set ourselves up for the next phase of growth.

The network effects of a global business platform

As the world becomes more tribal, global platforms, which enable the flow of commerce between countries, will help build communities, foster understanding, and deliver economic prosperity.

Connecting millions of people around the world, using business as the common ground, Xero is helping small businesses export and trade globally so that they can service markets beyond their geographical vicinity. To achieve this vision, we need to improve small business productivity and open up lines of capital – something technology is already achieving.

AUSTRALIA AND NEW ZEALAND LEADERSHIP

Xero continues to hold cloud accounting market leadership in the established markets of Australia and New Zealand with 692,000 subscribers, adding 194,000 subscribers in the year to 31 March 2017, compared to 157,000 subscribers added in the prior year.

One third of New Zealand's small businesses are on the Xero platform. Both Australia and New Zealand continue to win with strong growth from an expanding addressable market where Xero remains the preferred solution for accountants and bookkeepers. At less than 1% per month, churn is low and remains a key driver for a strong, sustainable business model.

UNITED KINGDOM GROWTH ENGINE

In the United Kingdom, Xero continues to lead the cloud accounting market, growing to 212,000 subscribers at 31 March 2017. Adding 79,000 subscribers for the year, the United Kingdom is Xero's next growth engine.

Xero is well positioned as the digitisation of the United Kingdom's businesses accelerate and upcoming Government legislation, 'Making Tax Digital', is implemented. Xero is already partnering with most of the major banks and successfully building an active accounting and bookkeeper channel.

We are building stronger connections between the United Kingdom's small businesses, advisors, and banks to help them grow and boost their success rates.

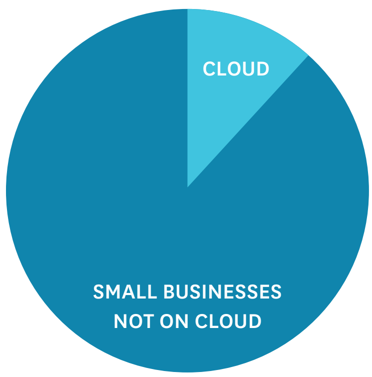
NORTH AMERICAN OPPORTUNITY

North America grew to 92,000 subscribers at 31 March 2017, adding 30,000 subscribers in the year to 31 March 2017, and is executing on its financial web strategy, striking important partnerships with top banks including Capital One, Wells Fargo and Silicon Valley Bank.

In the beginning, we had to go directly to small businesses to establish our presence. We're building scale and recognition in the accounting channel and can now go directly to large accounting firms, working with advisors right across the market including H&R Block and Carr, Riggs & Ingram (CRI).

We are building a strong cloud accounting position to capitalise on the North American growth opportunity. It's a market which is in the early stages of cloud accounting migration with a large proportion of small businesses yet to adopt any accounting solution.

NORTH AMERICAN CLOUD ACCOUNTING TRANSITION STILL IN EARLY PHASE*



**Estimated english speaking addressable cloud accounting market and based on publicly available data*

Market expansion

With technology advances further simplifying and automating core accounting processes, the industry has once again arrived at an inflection point.

Today, the majority of the more than 100 million small businesses globally can benefit from adopting cloud technology. We're working to expand the services we offer to help unlock small business productivity and widen Xero's global market opportunity to better serve more segments such as medium-sized businesses and the sole trader market.

NEW GEOGRAPHIES

Adoption of cloud accounting is accelerating globally as more markets adopt sales taxes and move to digitise taxation processes.

We have proven the Xero growth engine is replicable in new markets. With customers in more than 180 countries, our Rest of World subscriber growth (including South Africa and South East Asia) has posted another strong year, growing more than 60% to 39,000 subscribers at 31 March 2017.

Xero is gaining momentum across South East Asia where we have partnered with leading banks across the region, including HSBC in Hong Kong, UOB in Singapore, and CIMB in Malaysia. Over time, Xero aims to support more regions and languages.

BUILDING THE FINANCIAL WEB

The evolution of the financial web opens up a raft of opportunities for Xero. The growth of our ecosystem, combined with integrations with more than 110 financial institutions, means Xero can provide a greater range of tools and services for small business owners and their advisors.

In the past year alone, more than 700 million transactions were reconciled in Xero, over 150 million invoices were sent, and 120 million bills were received. Xero will continue to work in partnership with the banking sector to expand new revenue-driving tools, applications, and platform revenue.

Conclusion

The expanding global small business economy is becoming more important for the overall prosperity and health of the world economy. Increasingly, employment growth – particularly at scale – is driven by the hiring patterns of small businesses. We believe growing the small business economy is the best way to materially address major social issues such as job creation, youth unemployment, regional growth, and equality.

Xero has delivered another year of strong outcomes. Our global team is in place to support our continued growth, and we're excited to bring Xero to many more small businesses and accounting partners around the world to help them thrive as we head toward $1 billion in revenue.

Management Commentary

You should read the following commentary with the consolidated financial statements and the related notes in this report. Some parts of this commentary include information regarding the plans and strategy for the business, and include forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in the following commentary. All amounts are presented in New Zealand Dollars (NZD), except where indicated.

Non-GAAP measures have been included, as we believe they provide useful information for readers to assist in understanding Xero's financial performance. Non-GAAP financial measures should not be viewed in isolation nor considered as substitutes for measures reported in accordance with NZ IFRS.

BUSINESS RESULTS

Year ended 31 March	**2017 ($000s)**	**2016 ($000s)**	**change**
Subscription revenue	289,998	201,986	44%
Other operating revenue	5,391	5,074	6%
Total operating revenue	**295,389**	**207,060**	**43%**
Cost of revenue	(69,385)	(49,881)	39%
Gross profit	**226,004**	**157,179**	**44%**
Percentage of operating revenue	77%	76%	1pp*
Total operating expenses	**(297,918)**	**(248,791)**	**20%**
Percentage of operating revenue	101%	120%	-19pp
Foreign exchange and other income	1,170	2,538	-54%
Operating deficit	**(70,744)**	**(89,074)**	**-21%**
Percentage of operating revenue	-24%	-43%	19pp
Net interest income	3,674	8,122	-55%
Income tax expense	(1,987)	(1,512)	31%
Net loss	**(69,057)**	**(82,464)**	**-16%**
Percentage of operating revenue	-23%	-40%	17pp

**pp means percentage point*

The growth in operating revenue was driven by subscriber growth in all markets, while the strong NZD throughout the year compared to the previous year had an adverse impact on revenue. Cost of revenue decreased as a proportion of operating revenue, notwithstanding the duplicated platform costs incurred migrating to AWS and additional investment in hosting tools. Total operating expenses increased as Xero continued to invest in scaling its global business and delivering subscriber growth. Total operating revenue increased by 43% while operating expenses grew proportionately less driven by efficiencies, causing the operating deficit to be 21% lower than the previous year.

EARNINGS BEFORE INTEREST, TAX, DEPRECIATION, AND AMORTISATION (EBITDA)

EBITDA disclosures (which are non-GAAP financial measures) have been included, as we believe they provide useful information for readers to assist in understanding Xero's financial performance. EBITDA is calculated by adding back depreciation, amortisation, net interest income, and tax expense to net losses.

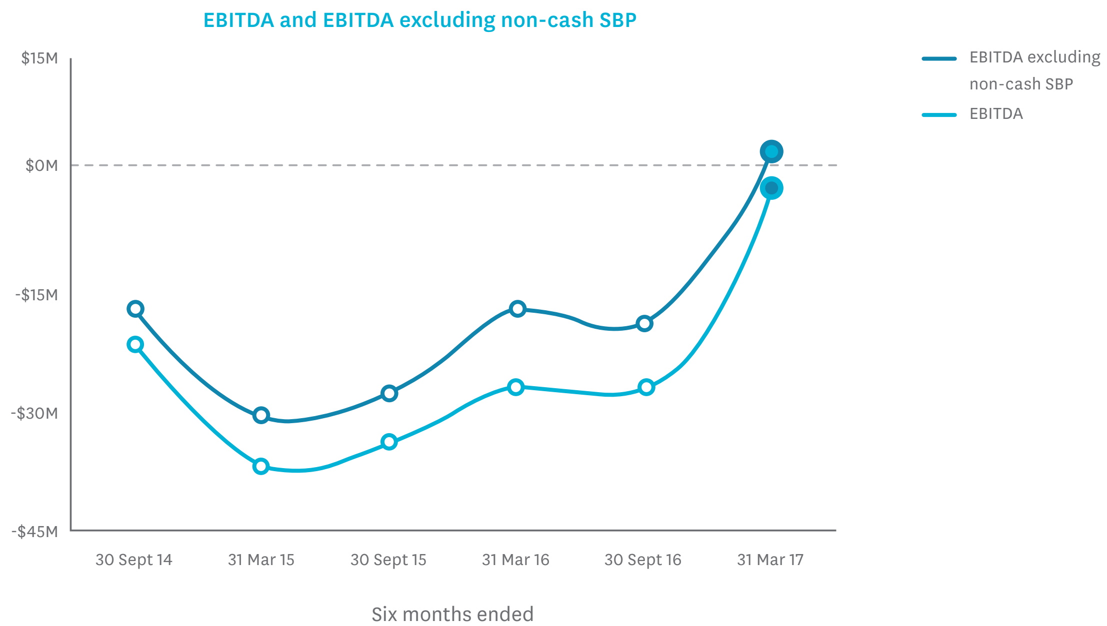
Year ended 31 March	2017 ($000s)	2016 ($000s)	change
Net loss	(69,057)	(82,464)	-16%
Add back: net interest income	(3,674)	(8,122)	-55%
Add back: depreciation and amortisation	42,130	29,143	45%
Add back: income tax expense	1,987	1,512	31%
EBITDA	**(28,614)**	**(59,931)**	**-52%**
EBITDA margin	-10%	-29%	19pp

EBITDA loss reduced by 52% compared to the year ended 31 March 2016, despite being affected by the comparably stronger NZD. The primary reason for this improvement was operating efficiencies across expense areas.

EBITDA excluding the impact of non-cash share-based payments (a non-GAAP financial measure) is also provided as we believe it provides useful information to analyse trends in cash-based expenses.

Year ended 31 March	2017 ($000s)	2016 ($000s)	change
EBITDA	**(28,614)**	**(59,931)**	**-52%**
Add back: non-cash share-based payments expenses	11,723	15,147	-23%
EBITDA excluding non-cash share-based payments	**(16,891)**	**(44,784)**	**-62%**
Percentage of operating revenue	-6%	-22%	16pp

EBITDA loss excluding non-cash share-based payments improved by $27.9 million when compared to the previous financial year. For the second half of the financial year, EBITDA excluding non-cash share-based payments at $1.6 million, was positive for the first time in Xero's history.



OPERATING REVENUE

Subscription revenue comprises recurring monthly fees from subscribers to Xero's online accounting software. Within a subscription, customers also receive support services and product updates.

Operating revenue also includes revenue from other related services, including attendance fees for conferences and events such as Xerocon, the implementation of online accounting software services, and revenue share agreements with other financial web service providers. Subscription revenue comprises around 98% of operating revenue.

Year ended 31 March	2017 ($000s)	2016 ($000s)	change	change in constant currency
Subscription revenue	289,998	201,986	44%	52%
Other operating revenue	5,391	5,074	6%	15%
Total operating revenue	**295,389**	**207,060**	**43%**	**51%**

The 44% increase in subscription revenue during the year was primarily driven by year-on-year subscriber growth of 44% from 717,000 to 1,035,000 subscribers at 31 March 2017. Other operating revenue remained relatively consistent with the prior year, even though there was an 11% reduction in conference income related to holding one less Xerocon compared to the previous year. The decrease in conference income was offset by increased financial web services revenue, resulting in an overall increase of 6% in the year ended 31 March 2017.

Constant currency operating revenue (a non-GAAP financial measure) is provided to assist in understanding and assessing Xero's financial performance during the year, excluding the impact of foreign currency fluctuations. Constant currency operating revenue is calculated by translating operating revenue for the 12 months ended 31 March 2017 at the effective exchange rates for the 12 months ended 31 March 2016.

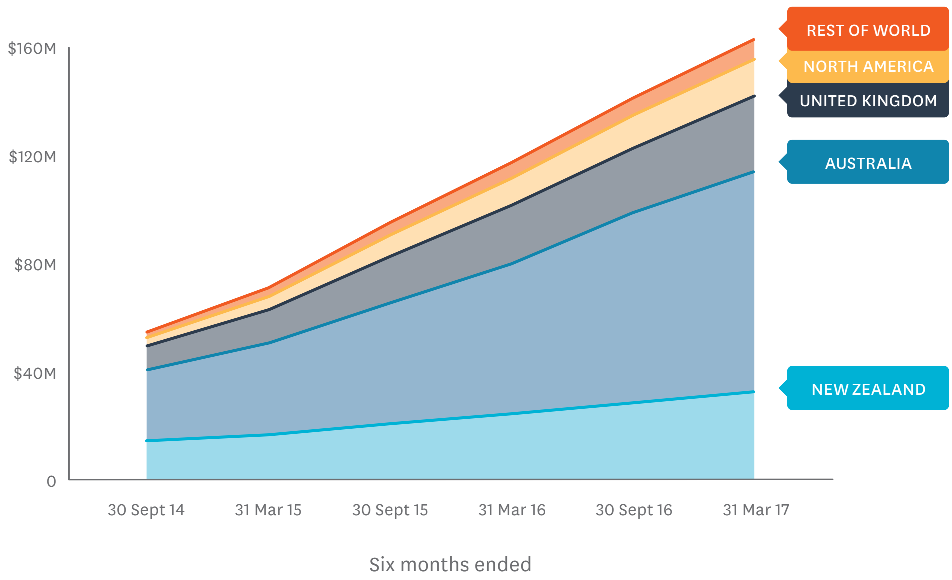
As 79% of Xero's operating revenue is denominated in foreign currencies, the comparatively stronger NZD during the year affected reported revenue. Constant currency operating revenue for the Group in the current period was $16.8 million higher than reported operating revenue, with year-on-year growth of 51%. Constant currency operating revenue growth was higher than the percentage increase in subscribers due to price changes.

OPERATING REVENUE – BY GEOGRAPHY

Year ended 31 March	2017 ($000s)	2016 ($000s)	change	change in constant currency
Australia	145,496	96,686	50%	54%
New Zealand	62,289	46,708	33%	33%
Australia and New Zealand (ANZ) total	**207,785**	**143,394**	**45%**	**47%**
United Kingdom	49,712	37,437	33%	62%
North America	24,817	16,850	47%	55%
Rest of World	13,075	9,379	39%	47%
International total	**87,604**	**63,666**	**38%**	**58%**
Total operating revenue	**295,389**	**207,060**	**43%**	**51%**

Operating revenue grew in all of Xero's geographies, with growth of 45% in the established ANZ markets largely due to the increased subscriber base and price changes. Constant currency revenue growth for the ANZ markets was 47%. Revenue growth rates in the International markets were more adversely impacted by movements in foreign exchange, in particular the impact of the United Kingdom's decision to leave the European Union on the NZD/GBP cross rate, causing the NZD to be 21% stronger on average throughout the year ended 31 March 2017 than the prior year. As a result, constant currency revenue growth in the International markets was 58% compared to actual currency growth of 38%, which was primarily driven by constant currency growth of 62% in the United Kingdom.

TOTAL GROUP OPERATING REVENUE – BY GEOGRAPHY*



*represents each region's contribution to total Group operating revenue for the respective 6 month period

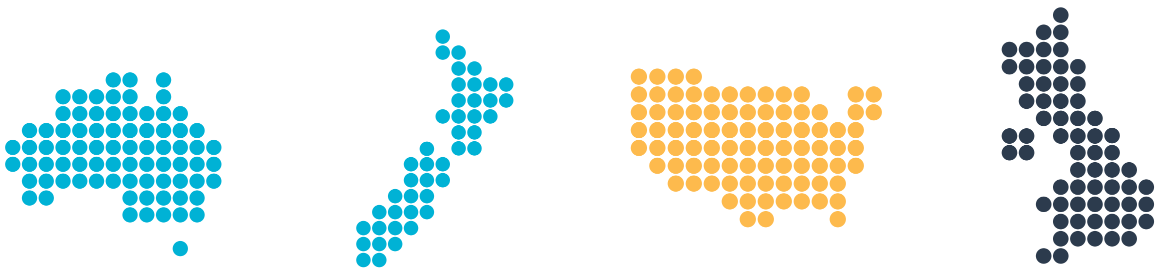
SUBSCRIBER NUMBERS

'Subscriber' means each unique subscription to a Xero-offered product that is purchased by an accounting partner or an end user and which is, or is available to be, deployed.

At 31 March	2017	2016	change
Australia	446,000	312,000	43%
New Zealand	246,000	186,000	32%
Australia and New Zealand (ANZ) total	**692,000**	**498,000**	**39%**
United Kingdom	212,000	133,000	59%
North America	92,000	62,000	48%
Rest of World	39,000	24,000	63%
International total	**343,000**	**219,000**	**57%**
Total paying subscribers	**1,035,000**	**717,000**	**44%**

318,000 subscribers were added in the 12 months to 31 March 2017, bringing total subscribers to 1,035,000, a 44% increase over subscribers at 31 March 2016. ANZ grew by 194,000 subscribers or 39% in the 12 month period, demonstrating strong growth even in our established markets. International subscribers grew at a higher rate, increasing by 124,000 or 57% in the 12 months ended 31 March 2017 compared to the 85,000 subscribers added in the 12 months ended 31 March 2016.

REGIONAL SUBSCRIBERS AT 31 MARCH 2017*



Australia
446,000
2016 // 312,000

New Zealand
246,000
2016 // 186,000

North America
92,000
2016 // 62,000

United Kingdom
212,000
2016 // 133,000

*Rest of World subscribers of 39,000 at 31 March 2017

ANNUALISED COMMITTED MONTHLY REVENUE

Annualised committed monthly revenue (ACMR, a non-GAAP financial measure) represents monthly recurring revenue at 31 March, multiplied by 12. It provides a 12 month forward view of revenue, assuming any promotions have ended and other factors such as subscriber numbers, pricing and foreign exchange remain unchanged during the year.

Constant currency ACMR (also a non-GAAP financial measure) is calculated by translating ACMR at 31 March 2017 at the foreign exchange rate at 31 March 2016, and is provided to assist in understanding and assessing year-on-year growth rates, excluding the impact of foreign currency fluctuations.

At 31 March	**2017 ($000s)**	**2016 ($000s)**	**change**	**change in constant currency**
ANZ	246,818	177,863	39%	40%
International	112,851	80,062	41%	55%
Total	**359,669**	**257,925**	**39%**	**45%**

The growth in ACMR was largely driven by subscriber growth, which was consistent with subscription revenue. $101.7 million of ACMR was added in the year ended 31 March 2017 compared to $98.6 million in the prior year. The stronger NZD at 31 March 2017 when compared to 31 March 2016 had a significant impact on ACMR growth. Group constant currency ACMR at 31 March 2017 was $115.0 million higher than the prior year, and year-on-year growth of 45% was consistent with subscriber growth.

The ANZ markets demonstrated solid growth due to strong net subscriber additions during the year with ACMR increasing at the same rate as subscribers. Year-on-year ACMR growth of 41% in the International markets represented strong growth in the subscriber base, offset by a comparatively stronger NZD against both the United States Dollar (USD) and Great British Pound (GBP). The International constant currency ACMR year-on-year growth rate was 55%.

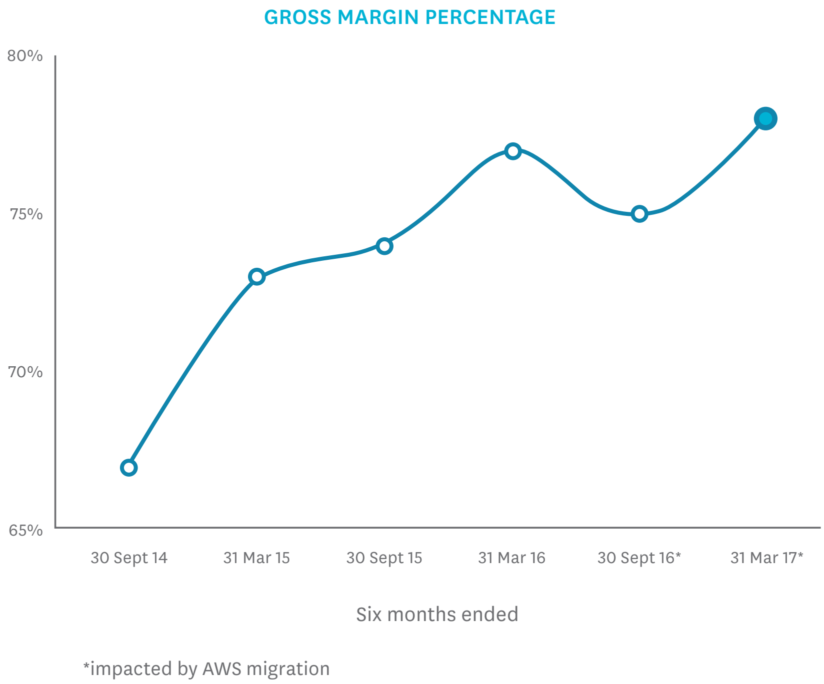
GROSS PROFIT

Gross profit represents operating revenue less cost of revenue. Cost of revenue consists of expenses directly associated with securely hosting Xero's services, sourcing relevant subscriber data from financial institutions and providing support to subscribers. The costs include hosting and content distribution costs, bank feed costs, personnel and related expenses (including salaries, benefits, bonuses and share-based payments) directly associated with cloud infrastructure and subscriber support, contracted third-party vendor costs, related depreciation and amortisation, and allocated overheads.

Year ended 31 March	**2017 ($000s)**	**2016 ($000s)**	**change**
Operating revenue	295,389	207,060	43%
Cost of revenue	(69,385)	(49,881)	39%
Gross profit	**226,004**	**157,179**	**44%**
Gross margin percentage	77%	76%	1pp

Cost of revenue for the year increased by $19.5 million, or 39%, to $69.4 million. The primary reasons for the change were increases in hosting costs and personnel costs related to an increased headcount in Xero's customer support teams required to support more subscribers. Hosting costs were impacted by the migration of the hosting platform to AWS, which required running two hosting platforms in parallel for a large part of the year, as well as increased investment in hosting tools and software. Operating revenue growth of 43% resulted in gross profit increasing by $68.8 million, or 44%, to $226.0 million.

Cost of revenue decreased as a percentage of operating revenue compared with the previous period due to efficiencies in the customer support teams and reductions in bank feed costs per subscriber. Notwithstanding the duplication of hosting costs related to the AWS migration that was completed in the third quarter, gross margin for the 12 months improved in the current year when compared to the prior year. Gross margin for the second half of the year ended 31 March 2017 improved to 78%.



SALES AND MARKETING

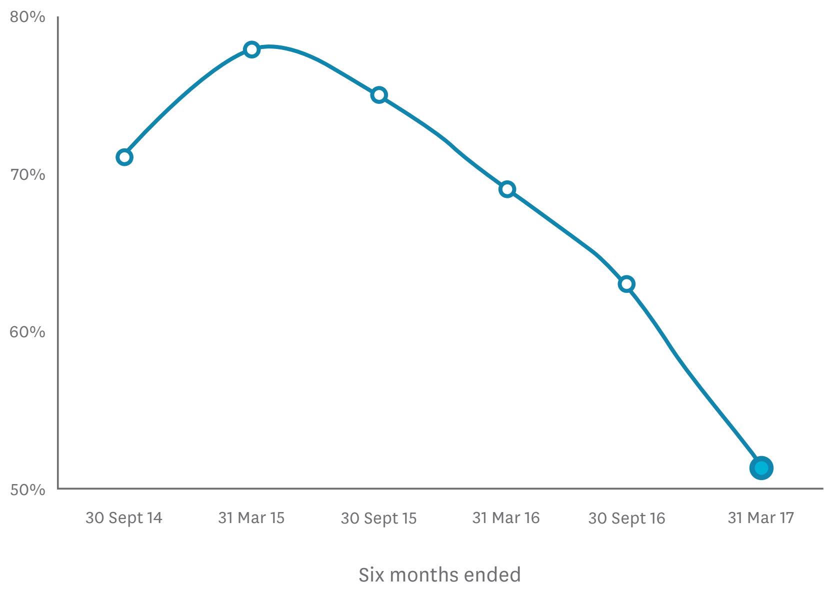
Sales and marketing expenses consist of personnel and related expenses (including salaries, benefits, bonuses, commissions and share-based payments) directly associated with the sales and marketing teams, the cost of educating and onboarding both partners and small business customers, and costs in the implementation of subscription services. Other costs included are external advertising costs, marketing costs and promotional events, as well as allocated overheads.

Year ended 31 March	2017 ($000s)	2016 ($000s)	change
Sales and marketing expenses	166,776	148,284	12%
Percentage of operating revenue	56%	72%	-16pp

Sales and marketing costs increased by $18.5 million or 12% to $166.8 million in the year ended 31 March 2017, compared to operating revenue growth of 43% and subscriber growth of 44%. The majority of sales and marketing costs are incurred in acquiring new subscribers and are expensed in the period, in contrast to the associated revenue from those subscribers which is recognised over the life of the subscriber (currently around seven years on average). The majority of the increase in absolute sales and marketing costs was incurred in the International markets, while costs in the ANZ markets grew at a lesser rate. The average cost of acquiring each subscriber, which was impacted by foreign exchange, decreased 15% in the year ended 31 March 2017 to $371 per gross subscriber added, as compared to $436 per gross subscriber added in the prior year.

As a percentage of operating revenue, sales and marketing costs decreased from 72% to 56% in the current year compared to the prior year, as sales and marketing costs grew at a slower rate than operating revenue. As a percentage of operating revenue, sales and marketing costs were lower in the second half of the year, totalling 51% of operating revenue as compared to 69% of operating revenue for the six months ended 31 March 2016.

SALES AND MARKETING AS A PERCENTAGE OF OPERATING REVENUE



PRODUCT DESIGN AND DEVELOPMENT

Product design and development costs consist primarily of personnel and related expenses (including salaries, benefits, bonuses and share-based payments) directly associated with product design and development employees, as well as allocated overheads.

The proportion of product design and development expenses that creates a benefit in future years is capitalisable as an intangible asset and is then amortised to the Income Statement over the estimated life of the asset created. The amount amortised relating to the Xero product and platform is included as a product design and development expense.

Year ended 31 March	2017 ($000s)	2016 ($000s)	change
Total product design and development costs (including amounts capitalised)	**120,204**	**99,001**	**21%**
Percentage of operating revenue	41%	48%	-7pp
Less capitalised development costs	(52,906)	(44,948)	18%
Product design and development expense excluding amortisation of amounts capitalised	**67,298**	**54,053**	**25%**
Less government grants	(3,050)	(3,472)	-12%
Add amortisation of capitalised development costs	29,017	19,083	52%
Product design and development expense	**93,265**	**69,664**	**34%**
Percentage of operating revenue	32%	34%	-2pp

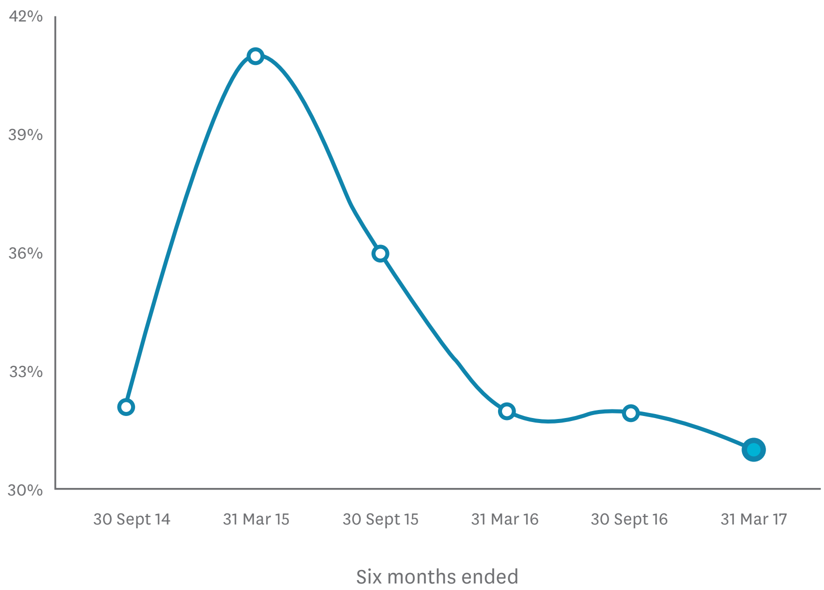
Xero continues to invest in its global product and platform, releasing a significant amount of product updates and successfully migrating the entire platform to the AWS environment. Total product design and development costs were $120.2 million in the year ended 31 March 2017, $21.2 million higher than the previous year. Of this, $52.9 million was capitalised, with the balance of $67.3 million included as an expense in the Income Statement. The amount capitalised represents a capitalisation rate of 44% of total product design and development costs for the year, which was one percentage point lower than the prior year.

The amortisation of capitalised product design and development expenditure of $29.0 million was included as an expense in the Income Statement giving a total net expense (after government grants) for the year of $93.3 million.

As a proportion of operating revenue, total product design and development costs including amounts capitalised decreased seven percentage points to 41% in the year ended 31 March 2017 from 48% for the previous period, as costs increased at a slower rate than revenue.

Non-cash amortisation of previously capitalised development costs also increased due to comparatively higher intangibles balances than in the prior year. As a proportion of operating revenue, product design and development expenses decreased to 32% in the year ended 31 March 2017 from 34% in the previous period.

PRODUCT DESIGN AND DEVELOPMENT AS A PERCENTAGE OF OPERATING REVENUE



GENERAL AND ADMINISTRATION

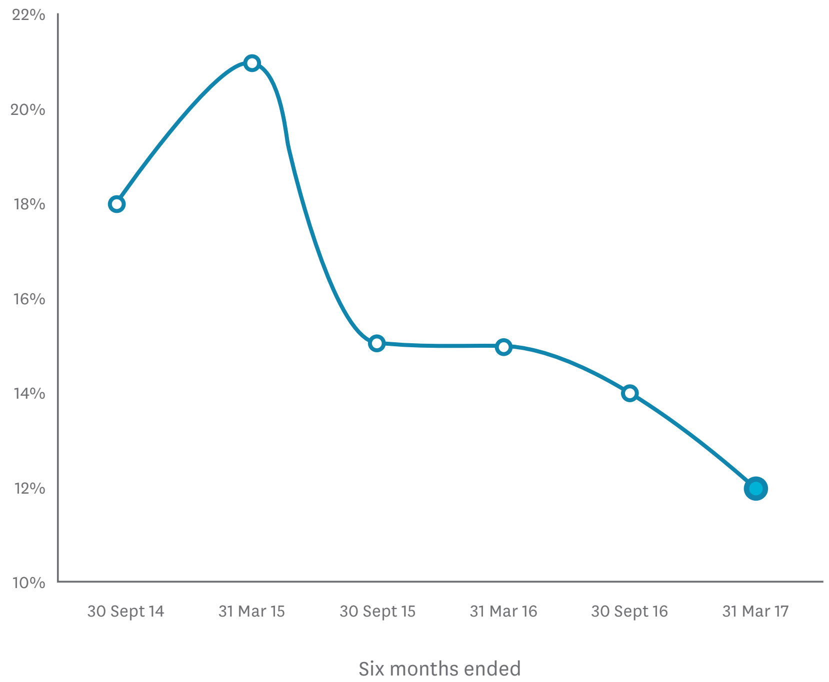
General and administration expenses consist of personnel and related expenses (including salaries, benefits, bonuses and share-based payments) for executive, finance, billing, legal, human resources and administrative employees. It also includes legal, accounting and other professional services fees, insurance premiums, other corporate expenses and allocated overheads.

Year ended 31 March	**2017 ($000s)**	**2016 ($000s)**	**change**
General and administration expenses	37,877	30,843	23%
Percentage of operating revenue	13%	15%	-2pp

General and administration costs were $37.9 million for the year ended 31 March 2017, $7.0 million or 23% higher than in the previous year. The increase was primarily due to increased personnel-related costs as a result of headcount growth to support improving infrastructure as Xero scales globally.

General and administration costs decreased as a proportion of operating revenue from 15% in the previous year to 13% in the year ended 31 March 2017.

GENERAL AND ADMINISTRATION AS A PERCENTAGE OF OPERATING REVENUE



EMPLOYEES

At 31 March	2017	2016	change
Total Group	1,721	1,430	20%

Full-time equivalent (FTE) employees increased by 291 or 20% in the year ended 31 March 2017 taking the total FTEs to 1,721, compared with a 44% increase in subscribers and 43% increase in operating revenue. The slower growth compared to revenue and subscribers reflects the benefits of economies of scale and operating efficiencies.

OTHER INCOME AND INTEREST

Year ended 31 March	2017 ($000s)	2016 ($000s)	change
Foreign exchange and other income			
Sublease income	1,128	758	49%
Foreign exchange gains	42	1,780	-98%
Total foreign exchange and other income	**1,170**	**2,538**	**-54%**
Interest			
Interest income	3,781	8,177	-54%
Interest expense	(107)	(55)	95%
Net interest income	**3,674**	**8,122**	**-55%**

Interest income in the year ended 31 March 2017 was $3.8 million, a decrease of $4.4 million or 54% from the previous year, due to lower cash and short-term deposit balances as well as New Zealand interest rates being lower in the year ended 31 March 2017.

CASH FLOWS

Year ended 31 March	2017 ($000s)	2016 ($000s)	change
Receipts from customers	288,448	199,737	44%
Other operating cash flows	(292,849)	(234,507)	25%
Total cash flows from operating activities	**(4,401)**	**(34,770)**	**-87%**
Investing activities	(66,430)	(53,820)	23%
Total operating and investing cash flows	**(70,831)**	**(88,590)**	**-20%**
Currency revaluation	(551)	2,507	NM*
Subtotal	**(71,382)**	**(86,083)**	**-17%**

**NM stands for not meaningful*

Receipts from customers increased 44% or $88.7 million to $288.4 million in line with operating revenue growth. Other operating cash outflows increased 25% or $58.3 million, to an outflow of $292.8 million in line with increases in operating and capital expenditure. Net cash outflows from operating activities reduced by $30.4 million or 87% compared to the same period last year, as revenue growth outpaced growth in expenditure.

Total operating and investing cash outflows decreased 17% from the previous year, due to increases in receipts from customers and increased discipline across operating and capital expenditure.

SEGMENT INFORMATION

	ANZ ($000s)	International ($000s)	Total ($000s)
Year ended 31 March 2017			
Operating revenue	207,785	87,604	295,389
Expenses	(113,199)	(122,962)	(236,161)
Other income	–	1,128	1,128
Segment contribution	**94,586**	**(34,230)**	**60,356**
Contribution margin percentage	46%	-39%	20%
Year ended 31 March 2016			
Operating revenue	143,394	63,666	207,060
Expenses	(93,982)	(104,183)	(198,165)
Other income	–	758	758
Segment contribution	**49,412**	**(39,759)**	**9,653**
Contribution margin percentage	34%	-62%	5%

Operating revenue is allocated to a segment depending on where the subscriber resides. Expenses include cost of revenue, sales and marketing costs incurred directly in-region, and an allocation of centrally managed costs and overheads, such as hosting and subscriber support costs.

ANZ – Operating revenue for the year ended 31 March 2017 grew by 45% compared to the previous year as subscribers increased by 39%. This, along with cost efficiencies, resulted in the segment contribution for the year improving as a percentage of operating revenue from 34% to 46%. The improvement was largely due to the performance in Australia, which added 134,000 subscribers in the year to finish with 446,000 paying subscribers, and revenue for the year grew 50% to $145.5 million.

International – Operating revenue grew by 38% based on subscriber growth of 57%. International markets were adversely impacted by a strong NZD during the period. In constant currency terms, International revenue growth was 58%, consistent with subscriber growth. The contribution margin was comparatively lower than that of ANZ, reflective of the investment to accelerate growth in the United Kingdom, North America and Asia as Xero builds brand recognition and distribution channels in its emerging markets. International's contribution loss slowed to $14.1 million in the second half of the year as compared to $20.1 million in the first half of the year ended 31 March 2017.

KEY SAAS METRICS

Average revenue per user (ARPU) is calculated as annualised committed monthly revenue (ACMR) at 31 March divided by subscribers at that time (and divided by 12 to get a monthly view).

CAC months or months of ARPU to recover CAC (cost of acquiring subscribers) represent the number of months of revenue required to recover the cost of acquiring each new subscriber. The calculation is sales and marketing costs for the year less conference revenue (such as Xerocon) divided by new subscribers added (gross) during the same period, divided by ARPU.

CMR churn is the value of committed monthly revenue (CMR) from subscribers who leave Xero in a month as a percentage of the total CMR at the start of that month. The percentage provided is the average of the monthly churn for the year.

Lifetime value (LTV) is the gross margin expected from a subscriber over the lifetime of that subscriber. This is calculated by taking the average subscriber lifetime (1 divided by CMR churn) multiplied by ARPU multiplied by the gross margin percentage. Group LTV is calculated as the sum of the individual segment LTVs, multiplied by segment subscribers, divided by total Group subscribers.

LTV/CAC is the ratio between the LTV (described above) and the cost to acquire that subscriber, e.g. the gross margin derived from a subscriber in ANZ is currently on average 10.8 times the cost of acquiring that subscriber.

The table below outlines key metrics across Xero's segments:

At 31 March 2017	**ANZ**	**International**	**Total**
ARPU ($)	29.7	27.4	29.0
CAC months	8.1	20.5	12.8
CMR churn	0.88%	1.77%	1.15%
Lifetime value per subscriber ($)	2,582	1,192	2,121
Lifetime value/CAC	10.8	2.1	5.7

At 31 March 2016	**ANZ**	**International**	**Total**
ARPU ($)	29.8	30.5	30.0
CAC months	9.1	23.5	14.5
CMR churn	0.91%	1.81%	1.19%
Lifetime value per subscriber ($)	2,454	1,305	2,103
Lifetime value/CAC	9.1	1.8	4.8

ANZ – ARPU decreased by less than 1% due to the comparatively stronger NZD against the Australian Dollar. In constant currency terms ARPU increased 1% over the prior year due to favourable product mix in Australia offset by a higher portion of new and existing subscribers in New Zealand adding lower ARPU products. Improved CMR churn and segment gross margin led to a higher LTV. CAC months at 31 March 2017 improved by 11% when compared to the prior year due to lower costs to acquire each subscriber. As a result of improvements across most metrics, LTV/CAC at 31 March 2017 increased 19% to 10.8.

International – ARPU decreased by 10% primarily due to the comparatively stronger NZD against the United States Dollar and Great British Pound. The impact of foreign exchange on ARPU, partially offset by the improvement in churn, led to a lower LTV at 31 March 2017. In constant currency terms LTV per subscriber was slightly higher than in the previous year. CAC months at 31 March 2017 improved by 13% as compared to the prior year. As a result of the 21% decrease in the average cost to acquire each subscriber, LTV/CAC at 31 March 2017 increased 17% to 2.1.

Total Group – CAC months decreased in the year to 12.8 months due to a 15% reduction in the average cost to acquire a subscriber. ARPU decreased by 3% due to foreign exchange. Using the same exchange rates as the prior period, constant currency ARPU remained slightly ahead. Notwithstanding the currency impact on ARPU, LTV increased 1% to $2,121 per subscriber, due to the improvements in churn and gross margin. Group constant currency LTV per subscriber at 31 March 2017 was 4% higher than at 31 March 2016. CAC months at 31 March 2017 improved by 12% when compared to the prior year. As a result of the decreased average cost to acquire each subscriber, LTV/CAC increased 19% to 5.7 for the year ended 31 March 2017.

Independent Auditor's Report to the Shareholders of Xero Limited

OPINION

We have audited the financial statements of Xero Limited ("the company") and its subsidiaries (together "the group") on pages 27 to 51, which comprise the consolidated statement of financial position of the group as at 31 March 2017, the consolidated income statement, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended of the group, and the notes to the consolidated financial statements including a summary of significant accounting policies.

In our opinion, the consolidated financial statements on pages 27 to 51 present fairly, in all material respects, the financial position of the group as at 31 March 2017 and its financial performance and cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

This report is made solely to the company's shareholders, as a body. Our audit has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (New Zealand). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We are independent of the group in accordance with Professional and Ethical Standard 1 (revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Ernst & Young has provided remuneration market data, Australian research and development tax credit related services, ISAE cyber security assurance work, a Cloud Controls (ccm) Gap Assessment, and other assurance services relating to the review of the Callaghan Innovation grant and share register audit to the group. We have no other relationship with, or interest in, Xero Limited or any of its subsidiaries. Partners and employees of our firm may deal with the group on normal terms within the ordinary course of trading activities of the business of the group.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of the audit report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

1. Capitalised Development Costs

WHY SIGNIFICANT

The Group capitalises costs incurred in the development of its software. These costs are then amortised over the estimated useful life of the software.

The Group's process for calculating the value of internally developed software involves judgment as it includes estimating time which staff spend developing software and determining the value attributable to that time. The Group's capitalised costs is disclosed in Note 11 to the consolidated financial statements.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

Our work on capitalised development costs focused on the Group's process for estimating the time spent by staff on software development that enhances the expected attributable future economic benefits of the asset. In obtaining sufficient audit evidence, for a sample of capitalised development projects, we:

- assessed the projects against the requirements of Accounting Standards - NZ IAS 38 *Intangible Assets* to determine if they were capital in nature;
- enquired of the Group regarding the process to set capitalisation rates for staff and assessed the reasonableness of these rates by observing the Company's review process;
- assessed capitalised costs with reference to actual payroll information;
- assessed the design and operating effectiveness of key controls over the payroll system and tested a sample of payroll data to contracts and other supporting evidence; and
- assessed the adequacy of the disclosures related to capitalised development costs in the consolidated financial statements.

2. Impairment of Capitalised Development Costs

WHY SIGNIFICANT

Intangible assets make up 86% of the Group's non-current assets. The most significant of these intangibles is capitalised development costs.

NZ IAS 38 Intangible Assets requires that finite life intangible assets be impairment tested whenever there is an indication that the intangible assets may be impaired and this assessment requires judgement. Disclosures relating to Intangible Assets, including key assumptions, are disclosed in Note 11 to the consolidated financial statements.

The assessment as to whether there are indicators of impairment requires judgement as it involves consideration of both internal and external sources of information. This includes assessing the useful life of the assets.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

We enquired and assessed the factors that the Group considered regarding impairment of intangibles and whether any indicators of impairment existed. This included considering:

- Significant changes in the extent or manner in which an asset is used;
- Potential or actual redundancy or disposal of developed software;
- Actual or forecast revenues or cash flows associated to the intangible assets;
- The amortisation period applied by the Group to developed software relative to its experience of software lifecycle; and
- Significant changes in the market in which the assets are used.

We assessed the adequacy of the disclosures related to impairment considerations in the financial statements.

INFORMATION OTHER THAN THE FINANCIAL STATEMENTS AND AUDITOR'S REPORT

The Directors are responsible for the Annual Report, which includes information other than the consolidated financial statements and auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

If, based upon the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The directors are responsible, on behalf of the entity, for the preparation and fair presentation of the consolidated financial statements in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing on behalf of the entity the group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or cease operations, or have no realistic alternative but to do so.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located at External Reporting Board's website: https://www.xrb.govt.nz/standards-for-assurance-practitioners/. This description forms part of our auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Grant Taylor.

Ernst + Young

Wellington
11 May 2017

Financial Statements

Income Statement

	Notes	Year ended 31 March 2017 ($000s)	2016 ($000s)
Subscription revenue		289,998	201,986
Other operating revenue		5,391	5,074
Total operating revenue	**4**	**295,389**	**207,060**
Cost of revenue	6	(69,385)	(49,881)
Gross profit		**226,004**	**157,179**
Operating expenses			
Sales and marketing		(166,776)	(148,284)
Product design and development		(93,265)	(69,664)
General and administration		(37,877)	(30,843)
Total operating expenses	**6**	**(297,918)**	**(248,791)**
Foreign exchange gains		42	1,780
Other income		1,128	758
Operating deficit		**(70,744)**	**(89,074)**
Net interest income	5	3,674	8,122
Net loss before tax		**(67,070)**	**(80,952)**
Income tax expense	7	(1,987)	(1,512)
Net loss		**(69,057)**	**(82,464)**
Earnings per share			
Basic and diluted loss per share	8	($0.50)	($0.60)

Statement of Comprehensive Income

	Note	Year ended 31 March 2017 ($000s)	2016 ($000s)
Net loss		(69,057)	(82,464)
Other comprehensive income/(loss)*			
Movement in cash flow hedges	18	2,029	(4,954)
Income tax effect of cash flow hedges		–	(846)
Translation of international subsidiaries		(1,414)	2,079
Total other comprehensive income/(loss) for the year		**615**	**(3,721)**
Total comprehensive loss for the year		**(68,442)**	**(86,185)**

**Items of other comprehensive income may be reclassified to the Income Statement*
The accompanying notes form an integral part of these financial statements

Statement of Changes in Equity

	Notes	Share capital ($000s)	Treasury shares ($000s)	Share-based payment reserve ($000s)	Accumulated losses ($000s)	Foreign currency translation reserve ($000s)	Cash flow hedge reserve ($000s)	Total equity ($000s)
Balance at 1 April 2016		**516,165**	**(12,819)**	**15,985**	**(237,938)**	**1,321**	**(3,625)**	**279,089**
Net loss		–	–	–	(69,057)	–	–	(69,057)
Other comprehensive income/(loss)		–	–	–	–	(1,414)	2,029	615
Total comprehensive loss		**–**	**–**	**–**	**(69,057)**	**(1,414)**	**2,029**	**(68,442)**
Transactions with owners:								
Share-based payments – employee restricted share plan	20	8,749	853	(334)	–	–	–	9,268
Share-based payments – restricted stock units	20	6,178	–	(3,422)	–	–	–	2,756
Share-based payments – restricted stock units withheld to pay tax	20	–	–	(3,026)	–	–	–	(3,026)
Share-based Director and advisor fees and options	20	76	–	(753)	–	–	–	(677)
Share-based payments – employee share options	20	–	–	3,547	–	–	–	3,547
Exercising of Director share options	14	763	–	(220)	–	–	–	543
Exercising of employee share options	14	652	–	(138)	–	–	–	514
Share-based payments – employee schemes arising on acquisition		–	1,993	(1,415)	–	–	–	578
Balance at 31 March 2017		**532,583**	**(9,973)**	**10,224**	**(306,995)**	**(93)**	**(1,596)**	**224,150**
Balance at 1 April 2015		**504,570**	**(12,565)**	**7,705**	**(155,474)**	**(758)**	**2,175**	**345,653**
Net loss		–	–	–	(82,464)	–	–	(82,464)
Other comprehensive income/(loss)		–	–	–	–	2,079	(5,800)	(3,721)
Total comprehensive loss		**–**	**–**	**–**	**(82,464)**	**2,079**	**(5,800)**	**(86,185)**
Transactions with owners:								
Share-based payments – employee restricted share plan	20	9,443	(254)	620	–	–	–	9,809
Share-based payments – restricted stock units	20	1,242	–	5,434	–	–	–	6,676
Share-based Director fees and options	20	70	–	844	–	–	–	914
Share-based payments – employee share options	20	–	–	548	–	–	–	548
Exercising of Director share options	14	209	–	(43)	–	–	–	166
Exercising of employee share options	14	631	–	(96)	–	–	–	535
Share-based payments – employee schemes arising on acquisition		–	–	973	–	–	–	973
Balance at 31 March 2016		**516,165**	**(12,819)**	**15,985**	**(237,938)**	**1,321**	**(3,625)**	**279,089**

The accompanying notes form an integral part of these financial statements

Statement of Financial Position

	Notes	At 31 March 2017 ($000s)	2016 ($000s)
Assets			
Current assets			
Cash and cash equivalents		27,699	39,024
Short-term deposits		86,000	145,000
Trade and other receivables	9	32,817	27,098
Short-term derivative assets	18	801	358
Other current assets		393	–
Total current assets		**147,710**	**211,480**
Non-current assets			
Property, plant and equipment	10	15,881	15,462
Intangible assets	11	125,619	97,779
Deferred tax assets	7	2,065	1,376
Long-term derivative assets	18	17	–
Other receivables		1,958	2,004
Total non-current assets		**145,540**	**116,621**
Total assets		**293,250**	**328,101**
Liabilities			
Current liabilities			
Trade and other payables	12	34,263	21,634
Employee entitlements		27,336	20,783
Current income taxes payable	7	1,105	311
Short-term provisions	13	555	63
Short-term derivative liabilities	18	2,397	3,983
Total current liabilities		**65,656**	**46,774**
Non-current liabilities			
Deferred tax liabilities	7	546	755
Long-term provisions	13	851	972
Long-term derivative liabilities	18	17	–
Other long-term liabilities		2,030	511
Total non-current liabilities		**3,444**	**2,238**
Total liabilities		**69,100**	**49,012**
Equity			
Share capital	14	522,610	503,346
Accumulated losses		(306,995)	(237,938)
Reserves		8,535	13,681
Total equity		**224,150**	**279,089**
Total liabilities and shareholders' equity		**293,250**	**328,101**

The accompanying notes form an integral part of these financial statements

Statement of Cash Flows

	Note	Year ended 31 March 2017 ($000s)	2016 ($000s)
Operating activities			
Receipts from customers		288,448	199,737
Other income		4,116	4,144
Interest received		4,766	9,852
Payments to suppliers and employees		(299,638)	(245,288)
Income tax paid		(2,093)	(3,215)
Net cash flows from operating activities	15	**(4,401)**	**(34,770)**
Investing activities			
Purchase of property, plant and equipment		(6,694)	(4,749)
Capitalised development costs		(57,976)	(47,749)
Other intangible assets		(1,641)	(1,192)
Rental bonds		(119)	(130)
Net cash flows from investing activities		**(66,430)**	**(53,820)**
Financing activities			
Exercising of share options		1,057	701
Repayment of management loan		–	540
Payments for short-term deposits		(112,000)	(145,000)
Proceeds from short-term deposits		171,000	210,000
Net cash flows from financing activities		**60,057**	**66,241**
Net decrease in cash and cash equivalents		**(10,774)**	**(22,349)**
Foreign currency translation adjustment		(551)	2,507
Cash and cash equivalents at the beginning of the year		**39,024**	**58,866**
Cash and cash equivalents at the end of the year		**27,699**	**39,024**

The accompanying notes form an integral part of these financial statements

Notes to the Financial Statements

1. REPORTING ENTITY AND STATUTORY BASE

Xero Limited (the Company) is a company registered under the Companies Act 1993 and is listed on Main Board of the New Zealand Stock Exchange (NZX) and the Australian Securities Exchange (ASX). The Company is an FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013. The financial statements of Xero Limited and its subsidiaries (together 'the Group' or 'Xero') have been prepared in accordance with the requirements of Part 7 of the Financial Markets Conduct Act 2013 and the NZX Main Board Listing Rules.

The financial statements of the Group for the year ended 31 March 2017 were authorised for issue in accordance with a resolution of the Directors on 11 May 2017.

The Group's principal activity is the provision of a platform for online accounting and business services to small businesses and their advisors.

2. BASIS OF ACCOUNTING

(a) Basis of preparation The financial statements of the Group have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). The Group is a for-profit entity for the purposes of complying with NZ GAAP. The financial statements comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and other New Zealand accounting standards and authoritative notices that are applicable to entities that apply NZ IFRS. The consolidated financial statements also comply with International Financial Reporting Standards.

Other than where described below, or in the notes, the financial statements have been prepared using the historical cost convention.

The financial statements are presented in New Zealand Dollars ($) (the 'presentation currency'). Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency').

(b) Changes in accounting policies and disclosures Apart from the changes noted below, the accounting policies adopted are consistent with those of the previous year.

During the year, the Group early adopted the International Accounting Standards Board's amendments to IFRS 2: Share-Based Payment as issued on 20 June 2016. The amendments provide clarification on the classification and measurement of specific share-based payment transactions for the purpose of eliminating diversity in practice. As a result of the changes, equity awards net settled to meet withholding tax obligations are equity classified in their entirety rather than being split between equity and liability relative to the proportion to be net settled. The balance that would have otherwise been liability classified is disclosed in Note 20. Per the amendments prior periods have not been restated on application.

(c) Standards or interpretations issued but not yet effective and relevant to the Group The International Accounting Standards Board has issued a number of standards, amendments and interpretations which are not yet effective and which may have an impact on the Group's financial statements. These are detailed below. The Group has not yet applied these in preparing these financial statements and is currently assessing whether to apply the standards in the first year of mandatory adoption or to early adopt.

- **(a) NZ IFRS 9: Financial Instruments – Classification and Measurement.** This standard addresses the classification, measurement and de-recognition of financial assets, financial liabilities, impairment of financial assets and hedge accounting, and will be effective for the year ended 31 March 2019. NZ IFRS 9 includes a revised model for classification and measurement, and will result in changes to financial statement disclosures. Management does not expect a significant change to the way in which the Group measures its financial statements as a result, but has not yet performed a full assessment.
- **(b) NZ IFRS 15: Revenue from Contracts with Customers.** This standard establishes the framework for revenue recognition and also requires the incremental costs of obtaining a contract to be capitalised and expensed over the contract term. Costs of obtaining a contract are currently expensed as incurred. As a majority of Xero's customers are on monthly terms, management does not expect the recognition and measurement of revenue to materially change under the new standard, however, a full assessment has not yet been performed. The standard is effective for the year ended 31 March 2019.
- **(c) NZ IFRS 16: Leases.** This standard impacts the way in which the Group accounts for its operating leases, requiring a lessee to recognise a lease liability reflecting the future lease payments and a 'right-of-use asset' for substantively all lease contracts. The standard is effective for the year ended 31 March 2020. At 31 March 2017 the Group has non-cancellable operating lease commitments totalling $61.6 million, however the Group has not yet performed a full assessment as to what extent these commitments will result in the recognition of an asset and a liability for future payments and how this will affect the Group's financial statements.

(d) Critical accounting estimates In applying the Group's accounting policies, management continually evaluates judgements, estimates and assumptions based on experience and other factors, including expectations of future events that may have an impact on the Group. All judgements, estimates and assumptions made are believed to be reasonable based on the most current set of circumstances available to the Group. Actual results may differ from the judgements, estimates and assumptions.

The significant judgements, estimates and assumptions made by management in the preparation of these financial statements are outlined below.

Deferred tax assets The Group recognises a deferred tax asset in relation to tax losses, only to the extent of the Group's deferred tax liabilities. The Group has not recognised a deferred tax asset in respect of additional losses and other temporary differences given the uncertainty of the timing of profitability and the requirement for ownership continuity. Deferred tax assets and deferred tax liabilities are recognised in subsidiaries in respect of temporary differences; assets are only recognised to the extent that it is probable the assets will be utilised.

Capitalised development costs The Group capitalises a proportion of costs (including employee costs) related to software development. Judgement is required in determining the appropriate capitalisation rate and when to commence capitalisation. The Group regularly reviews the carrying value of capitalised development costs to ensure they are not impaired. The capitalised development costs are amortised over three to five years, with limited exceptions to this for assets specifically identified as having shorter useful lives.
At 31 March 2017, if capitalisation rates had been 10% higher/lower with all other variables held constant, the impact on operational expenses would have been $12.0 million lower/higher.

3. SEGMENT INFORMATION

The Group operates in one business segment, providing online solutions for small businesses and their advisors.

Xero has two operating segments, Australia and New Zealand (ANZ) and International. These segments have been determined based on the way the Global Executive team (the chief operating decision-maker) reviews financial performance.

Segment operating expenses represent sales and marketing costs and service delivery costs, including both in-country and an allocation of centrally managed costs.

	ANZ ($000s)	International ($000s)	Total ($000s)
Year ended 31 March 2017			
Operating revenue	207,785	87,604	295,389
Expenses	(113,199)	(122,962)	(236,161)
Other income	–	1,128	1,128
Segment contribution	**94,586**	**(34,230)**	**60,356**
Year ended 31 March 2016			
Operating revenue	143,394	63,666	207,060
Expenses	(93,982)	(104,183)	(198,165)
Other income	–	758	758
Segment contribution	**49,412**	**(39,759)**	**9,653**

Reconciliation from segment contribution to net loss before income tax

Year ended 31 March	2017 ($000s)	2016 ($000s)
Segment contribution	60,356	9,653
Product design and development	(93,265)	(69,664)
General and administration	(37,877)	(30,843)
Foreign exchange gains	42	1,780
Net interest income	3,674	8,122
Net loss before tax	**(67,070)**	**(80,952)**

At 31 March 2017, $133.5 million, or 95%, of the Group's property, plant and equipment and intangible assets was domiciled in New Zealand (2016: $104.0 million)

Depreciation and amortisation by segment

Year ended 31 March	2017 ($000s)	2016 ($000s)
ANZ	2,954	1,984
International	4,045	3,263
Corporate (not allocated to a segment)	35,131	23,896
Total	**42,130**	**29,143**

Employee entitlements: share-based payments by segment

Year ended 31 March	2017 ($000s)	2016 ($000s)
ANZ	3,349	3,666
International	2,655	4,380
Corporate (not allocated to a segment)	4,542	6,691
Total	**10,546**	**14,737**

4. REVENUE

Subscription revenue

Subscription revenue comprises the recurring monthly fees from subscribers to Xero's online accounting software services. Revenue is recognised as the services are provided to the subscribers. Unbilled revenue at year end is recognised in the Statement of Financial Position as accrued income and included within trade and other receivables.

Other operating revenue

Other operating revenue comprises revenue from related services such as education and the implementation of the online accounting software services, along with conference income. Revenue is recognised as the services are provided to the customers.

Revenue by geographic location

Year ended 31 March	2017 ($000s)	2016 ($000s)
Australia	145,496	96,686
New Zealand	62,289	46,708
United Kingdom	49,712	37,437
North America	24,817	16,850
Rest of World	13,075	9,379
Total	**295,389**	**207,060**

5. NET INTEREST INCOME

Interest income is recognised as it is accrued using the effective interest method. The effective interest method calculates the amortised cost of the financial asset and allocates the interest income over its expected life.

Year ended 31 March	2017 ($000s)	2016 ($000s)
Interest income – cash and short-term deposits	3,781	8,172
Interest income – loans to key management personnel	–	5
Interest expense	(107)	(55)
Total net interest income	**3,674**	**8,122**

6. EXPENSES

Overhead allocation

The presentation of the Income Statement by function requires certain overhead costs to be allocated to functions. These allocations require management to apply judgement. Facilities, internal information technology costs and depreciation and amortisation not relating to product software development have been allocated to each function on a headcount basis. Recruitment costs have been allocated according to the number of employees hired in each function during the period. The amortisation of product-related software development is included in product design and development.

Sales tax

The Income Statement and the Statement of Cash Flows have been prepared so that all components are stated exclusive of sales tax, except where sales tax is not recoverable. All items in the Statement of Financial Position are stated net of sales tax with the exception of receivables and payables, which include sales tax invoiced. Sales tax includes Goods and Services Tax and Value Added Tax, where applicable.

Year ended 31 March	**2017 ($000s)**	**2016 ($000s)**
Cost of revenue and operating expenses		
Employee entitlements	188,937	159,210
Employee entitlements – share-based payments	22,860	18,563
Employee entitlements capitalised	(50,975)	(42,690)
Platform costs	31,821	18,277
Advertising and marketing	59,838	53,781
Consulting and contractors	11,518	13,082
Rental costs	11,224	9,909
Travel-related costs	7,146	6,453
Communication and office administration	5,056	4,123
Staff recruitment	2,012	2,064
Superannuation costs	6,867	5,085
Computer equipment and software	7,302	4,547
Directors' fees	486	796
Auditors' remuneration	355	460
Other operating expenses	20,726	15,869
Total cost of revenue and operating expenses excl. depreciation and amortisation*	**325,173**	**269,529**

** Includes grant income of $3.1 million (2016: $3.5 million)*

Depreciation and amortisation

Relating to:		
Amortisation of development costs	33,834	22,019
Amortisation of other intangible assets	1,661	698
Depreciation of property, plant and equipment	6,635	6,426
Total depreciation and amortisation	**42,130**	**29,143**
Total cost of revenue and operating expenses	**367,303**	**298,672**

Depreciation and amortisation included in function expenses as follows:		
Cost of revenue	3,123	2,348
Sales and marketing	3,876	2,898
Product design and development	34,114	23,145
General and administration	1,017	752
Total depreciation and amortisation	**42,130**	**29,143**

Year ended 31 March	2017 ($000s)	2016 ($000s)

Auditors' remuneration

Audit and review of financial statements – EY	236	205
Taxation services – EY	28	42
Other services* – EY	4	15
Other assurance services** – EY	87	–
Other assurance services*** – PWC	–	198
Total fees paid to auditors	**355**	**460**

** Services relate to the provision of remuneration market data*
*** Services relate to assurance services in connection with reporting on service organisation controls, and compliance engagement in respect of grant application, and share register*
**** Services relate to assurance services in relation to the preparation of US GAAP compliant financial statements, audit of the Company's share register and compliance engagement in respect of grant application*

7. CURRENT AND DEFERRED INCOME TAX

Tax expense comprises current and deferred tax. Income tax is recognised in the Income Statement except when it relates to items recognised directly in other comprehensive income (in which case the income tax is recognised in other comprehensive income). Income tax is based on tax rates and regulation enacted in the jurisdictions in which the entities operate.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is based on the expected manner of realisation of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the end of the reporting period.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Current income tax

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the New Zealand statutory income tax rate as follows:

Year ended 31 March	2017 ($000s)	2016 ($000s)
Accounting loss before income tax	(67,070)	(80,952)
At the New Zealand statutory income tax rate of 28%	(18,780)	(22,667)
Non-deductible expenditure	1,570	1,317
Prior period adjustment	(180)	(490)
Impact of prior year research and development credit	(154)	(510)
Tax rate variance of subsidiaries	184	166
Total tax losses not recognised	19,347	23,696
Income tax expense	**1,987**	**1,512**
Comprising:		
Income tax payable	2,631	2,788
Prior period adjustment	(180)	(490)
Impact of prior year research and development credit	(154)	(510)
Deferred tax	(255)	(1,228)
Tax losses utilised	–	846
Effect of changes in foreign currency	(55)	106
Income tax expense	**1,987**	**1,512**

Income tax payable

At 31 March	2017 ($000s)	2016 ($000s)
Opening balance	311	2,218
Prior period adjustment	465	(1,165)
Impact of prior year research and development credit	(154)	(510)
Income tax liability for the year	2,631	2,788
Income tax paid	(2,093)	(3,215)
Effects of changes in foreign currency	(55)	195
Current tax payable	**1,105**	**311**

Deferred income tax

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	Derivatives ($000s)	Provisions and employee benefits ($000s)	Tax depreciation ($000s)	Tax losses ($000s)	Total ($000s)
Year ended 31 March 2017					
Deferred tax asset balances:					
At 1 April 2016	–	1,689	(313)	–	1,376
Prior period adjustment	–	742	(95)	–	647
Charged to Income Statement	–	450	479	(884)	45
Foreign currency adjustment	–	(2)	(1)	–	(3)
At 31 March 2017	**–**	**2,879**	**70**	**(884)**	**2,065**
Deferred tax liability balances:					
At 1 April 2016	1,015	2,228	(6,992)	2,994	(755)
Prior period adjustment	–	(168)	(6)	173	(1)
Charged to Income Statement	–	401	(3,588)	3,397	210
Charged to other comprehensive income	(568)	–	–	568	–
At 31 March 2017	**447**	**2,461**	**(10,586)**	**7,132**	**(546)**
Year ended 31 March 2016					
Deferred tax asset balances:					
At 1 April 2015	-	1,247	180	-	1,427
Prior period adjustment	-	(882)	(191)	-	(1,073)
Charged to Income Statement	-	1,231	(302)	-	929
Foreign currency adjustment	-	93	-	-	93
At 31 March 2016	**-**	**1,689**	**(313)**	**-**	**1,376**
Deferred tax liability balances:					
At 1 April 2015	(846)	1,691	(4,650)	2,352	(1,453)
Prior period adjustment	-	99	77	223	399
Charged to Income Statement	-	438	(2,419)	2,280	299
Charged to other comprehensive income	1,861	-	-	(1,015)	846
Tax losses utilised	-	-	-	(846)	(846)
At 31 March 2016	**1,015**	**2,228**	**(6,992)**	**2,994**	**(755)**

The Group's deferred tax asset and deferred tax liability are expected to be recovered by $0.6 million and $0.2 million respectively within the next 12 months. Deferred tax assets and liabilities have been offset where the balances are due to/receivable from the same counterparties. Deferred income tax assets are recognised for carried forward tax losses to the extent of deferred tax liabilities. The Group has unrecognised tax losses available to carry forward of $325,677,000 (2016: $241,082,000) subject to shareholder continuity being maintained.

8. EARNINGS PER SHARE

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares.

Basic EPS is calculated by dividing the net loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares on issue during the year, excluding shares purchased and held as treasury shares.

Diluted EPS is determined by adjusting the net loss attributable to ordinary shareholders and the weighted average number of ordinary shares on issue for the effects of all dilutive potential ordinary shares, which comprise treasury shares, options and Restricted Stock Units (RSUs) granted to employees and Directors and advisors. Potential ordinary shares are treated as dilutive when their conversion to ordinary shares would decrease EPS or increase the loss per share.

Year ended 31 March	**2017 (000s)***	**2016 (000s)***
Weighted average number of issued ordinary shares	137,366	136,429
Net loss after tax	($69,057)	($82,464)
Basic and diluted loss per share (in New Zealand Dollars)	**($0.50)**	**($0.60)**

**Except for per share amounts*

9. TRADE AND OTHER RECEIVABLES

Trade and other receivables are initially recognised at the fair value of the amounts to be received, plus transaction costs (if any). They are subsequently measured at amortised cost (using the effective interest method) less impairment losses.

At 31 March	**2017 ($000s)**	**2016 ($000s)**
Trade receivables	11,843	8,708
Provision for doubtful debts	(157)	(134)
Accrued income	14,036	9,719
Prepayments	5,340	6,463
Interest receivable	330	1,316
Government grant receivable	984	964
Rental bonds and other receivables	441	62
Total current trade and other receivables	**32,817**	**27,098**

Trade receivables are related primarily to the monthly subscriptions charged for the Xero software. Subscriptions are charged monthly in arrears. At 31 March 2017 trade receivables of the Group of $423,000 were past due and are considered partially impaired (2016: $367,000).

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at historical cost less depreciation.

Depreciation on assets is charged on a straight-line basis to allocate the differences between their original cost and the residual values over their estimated useful lives, as follows:

Leasehold improvements	Term of lease
Motor vehicles	5 years
Computer equipment	2-3 years
Furniture and equipment	2-7 years

The assets' residual values and useful lives are reviewed and adjusted if appropriate at each balance date. If an asset's carrying amount is greater than its estimated recoverable amount, the carrying amount is immediately written down to its recoverable amount.

	Leasehold improvements ($000s)	Motor vehicles ($000s)	Computer equipment ($000s)	Furniture and equipment ($000s)	Total ($000s)
Cost					
Balance at 1 April 2016	11,649	214	6,183	8,864	26,910
Additions	3,417	–	2,999	1,198	7,614
Disposals	(685)	(67)	(2,676)	(299)	(3,727)
Foreign exchange adjustment	(379)	–	(175)	(205)	(759)
Balance at 31 March 2017	**14,002**	**147**	**6,331**	**9,558**	**30,038**
Accumulated depreciation					
Balance at 1 April 2016	4,685	152	3,351	3,260	11,448
Depreciation expense	2,536	32	2,355	1,712	6,635
Disposals	(669)	(49)	(2,618)	(291)	(3,627)
Foreign exchange adjustment	(150)	–	(79)	(70)	(299)
Balance at 31 March 2017	**6,402**	**135**	**3,009**	**4,611**	**14,157**
Net book value at 31 March 2017	**7,600**	**12**	**3,322**	**4,947**	**15,881**
Cost					
Balance at 1 April 2015	9,738	212	6,286	7,899	24,135
Additions	1,778	–	1,771	1,045	4,594
Disposals	(225)	–	(2,105)	(381)	(2,711)
Foreign exchange adjustment	358	2	231	301	892
Balance at 31 March 2016	**11,649**	**214**	**6,183**	**8,864**	**26,910**
Accumulated depreciation					
Balance at 1 April 2015	2,541	118	2,950	1,895	7,504
Depreciation expense	2,300	32	2,371	1,723	6,426
Disposals	(222)	–	(2,037)	(374)	(2,633)
Foreign exchange adjustment	66	2	67	16	151
Balance at 31 March 2016	**4,685**	**152**	**3,351**	**3,260**	**11,448**
Net book value at 31 March 2016	**6,964**	**62**	**2,832**	**5,604**	**15,462**

11. INTANGIBLE ASSETS

Costs that are directly associated with the development of software are recognised as intangible assets where the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Software development costs that meet the above criteria are capitalised. Other development expenditure that does not meet the above criteria is recognised as an expense as incurred. Development costs previously recognised as expenses are not recognised as assets in a subsequent period. Software development costs recognised as assets are amortised over their estimated useful lives.

Other intangible assets acquired are initially measured at cost. Internally generated assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in the Income Statement when the expenditure is incurred.

With the exception of goodwill, the useful lives of the Group's intangible assets are assessed to be finite. Assets with finite lives are amortised over their useful lives and tested for impairment whenever there are indications that the assets may be impaired.

Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful life of the intangible asset, from the date it is available for use. The estimated useful lives are as follows:

Capitalised software development costs	3-5 years
Software licence costs	1-3 years
Patents, domains and trademark costs	10 years

Research costs and costs associated with maintenance are recognised as an expense as incurred.

Impairment considerations

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of the recoverable amount. Where the carrying value of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell or the asset's value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

Goodwill is tested at least annually for impairment, or whenever an indicator of impairment exists.

An impairment loss is recorded if its recoverable amount is less than its carrying amount. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate.

	Software development* ($000s)	Software licences ($000s)	Other intangible assets ($000s)	Goodwill ($000s)	Total ($000s)
Cost					
Balance at 1 April 2016	138,489	2,807	975	5,352	147,623
Additions**	62,971	364	–	–	63,335
Disposals	(16,367)	(1,167)	(34)	–	(17,568)
Balance at 31 March 2017	**185,093**	**2,004**	**941**	**5,352**	**193,390**
Accumulated amortisation					
Balance at 1 April 2016	48,840	415	589	–	49,844
Amortisation	33,834	1,610	51	–	35,495
Disposals	(16,367)	(1,167)	(34)	–	(17,568)
Balance at 31 March 2017	**66,307**	**858**	**606**	**–**	**67,771**
Net book value at 31 March 2017	**118,786**	**1,146**	**335**	**5,352**	**125,619**
Cost					
Balance at 1 April 2015	85,918	350	816	5,352	92,436
Additions	52,877	2,653	159	–	55,689
Disposals	(306)	(196)	–	–	(502)
Balance at 31 March 2016	**138,489**	**2,807**	**975**	**5,352**	**147,623**
Accumulated amortisation					
Balance at 1 April 2015	26,821	223	280	–	27,324
Amortisation	22,019	389	309	–	22,717
Disposals	–	(197)	–	–	(197)
Balance at 31 March 2016	**48,840**	**415**	**589**	**–**	**49,844**
Net book value at 31 March 2016	**89,649**	**2,392**	**386**	**5,352**	**97,779**

** Included in software development are projects in progress with a year end balance of $1.1 million (2016: $2.0 million)*

*** Includes $12.9 million of externally purchased assets (2016: $8.6 million)*

Goodwill and goodwill impairment testing Goodwill represents the excess of purchase consideration over the fair value of net assets acquired in a business. Goodwill is allocated to cash-generating units (CGUs), which are the lowest level of assets for which separately identifiable cash flows can be attributed. Xero's goodwill relates to the acquisition of Monchilla, Inc and has been allocated to the North American market.

The recoverable amount of the North American market was calculated on the basis of value in use using a discounted cash flow model. Future cash flows were projected for 10 years, based on Board-approved business plans, with key assumptions being CGU earnings and capital expenditure for the CGU based on the market's forecasts of expected performance. A period of 10 years has been used in the discounted cashflow model due to the early stage of growth the market is in.

A terminal growth rate of 2.5% (2016: 2.5%) was applied and a pre-tax discount rate of 12% (2016: 12%) was utilised. The terminal growth rate is determined based on the long-term anticipated growth rate of the business. The forecast financial information is based on both past experience and future expectations of CGU performance. The major inputs and assumptions used in performing an impairment assessment that require judgement include revenue forecasts, operating cost projections, discount rates, terminal growth rates and future technology paths.

During the year ended 31 March 2017 no impairment arose as a result of the review of goodwill. The recoverable amount of the North American CGU is greater than the carrying amount and, based on sensitivity analysis performed, no foreseeable changes in the assumptions would cause the carrying amount of the CGU to exceed its recoverable amount.

12. TRADE AND OTHER PAYABLES

The Group recognises trade and other payables initially at fair value and subsequently at amortised cost using the effective interest method. The amounts are unsecured, non-interest bearing and usually paid within 45 days of recognition.

At 31 March	2017 ($000s)	2016 ($000s)
Trade payables	11,352	9,609
Accrued expenses	16,568	8,685
Income in advance	1,551	789
Sales tax payable	4,792	2,551
Total current trade and other payables	**34,263**	**21,634**

13. PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

Provisions relate to make-good obligations arising from leases of office space, as well as obligations associated with an existing office lease to be vacated and reassigned. The non-current portion will be utilised by 2023.

	Make-good provision ($000s)	Lease provision ($000)	Total ($000)
Balance at 1 April 2016	1,035	–	1,035
Provisions made during the year	13	455	468
Provisions utilised during the year	(14)	–	(14)
Unwinding of discount	26	–	26
Foreign exchange adjustment	(109)	–	(109)
Balance at 31 March 2017	**951**	**455**	**1,406**
Current	100	455	555
Non-current	851	–	851

14. SHARE CAPITAL

At 31 March	Note	2017 (000s)	2016 (000s)
Balance at 1 April		136,814	136,008
Issue of ordinary shares – Employee Restricted Share Plan	20	466	545
Issue of ordinary shares – Exercising of employee options	20	94	155
Issue of ordinary shares – Director exercising options		34	33
Issue of ordinary shares – Directors' fees		4	4
Issue of ordinary shares – RSU schemes	20	349	69
Ordinary shares on issue at 31 March		**137,761**	**136,814**
Treasury shares		(634)	(791)
Ordinary shares on issue at 31 March excluding treasury shares		**137,127**	**136,023**

All shares have been issued, are fully paid and have no par value.

During the period the Company allocated 498,062 shares under the Employee Restricted Share Plan (RSP), at an average price of $18.71 (2016: 615,219, $17.44). Of the shares allocated, 466,180 were new shares issued, and 31,882 were the reissue of shares held as treasury stock (2016: 544,566 and 70,653 respectively).

During the period employees exercised 93,911 share options under the U.S. Equity Incentive Scheme, with an average exercise price of $5.48 (2016: 154,780, $4.37).

During the period a Director exercised 33,746 share options under the U.S. Equity Incentive Scheme, with an average exercise price of $16.09 (2016: 33,334, $4.97).

During the period the Company issued 3,957 shares at a weighted average price of $19.11 to Lee Hatton in lieu of cash payment for Directors' fees (2016: 4,093 shares were issued to Lee Hatton at $17.10).

During the period, 519,372 Restricted Stock Units (RSUs) vested, of which 349,049 were converted to shares with an average price of $17.70, the remaining 118,819 being surrendered to settle payroll tax liabilities (2016: 68,779 vested and converted with an average price of $18.41).

15. RECONCILIATION OF OPERATING CASH FLOWS

Year ended 31 March	2017 ($000s)	2016 ($000s)
Net loss after tax	(69,057)	(82,464)
Adjustments:		
Depreciation	6,635	6,426
Amortisation	35,495	22,717
Deferred tax	(255)	(1,228)
Tax losses utilised	–	846
Gain on foreign exchange transactions	(42)	(1,780)
Loss on disposal of property, plant and equipment	70	373
Employee share-based payments	10,546	14,737
Non-employee share-based payments	1,177	410
Bad debts	813	542
Other non-cash items	107	276
Changes in working capital:		
Increase in trade receivables and prepayments	(5,969)	(7,301)
Decrease in interest receivable	986	1,675
Increase in trade payables and accruals	8,635	5,652
Increase/(decrease) in current tax payable	794	(1,907)
Increase in employee entitlements	4,902	6,453
Increase/(decrease) in income in advance	762	(197)
Net cash flows from operating activities	**(4,401)**	**(34,770)**

16. KEY MANAGEMENT PERSONNEL AND RELATED PARTIES

Key management personnel

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, and include the Directors, the Chief Executive, and his direct reports. The following table summarises remuneration paid to key management personnel.

Year ended 31 March	2017 ($000s)	2016 ($000s)
Short-term employee benefits	10,108	7,094
Directors' fees	486	796
Share-based payments – options	1,556	201
Share-based payments – restricted stock units	967	2,146
Share-based payments – employee restricted share plan	2,039	2,959

The above table excludes the costs of options granted to Directors in their capacity as strategic advisors. As a result of the resignation of a Director in the year, unexercised options were forfeited resulting in a net credit of $884,000, relating to costs recognised in prior years being reversed in the Income Statement (2016 expense of $485,000).

A number of key management personnel, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. A number of these entities subscribe to the Xero services provided by the Group. None of these related party transactions are significant to either party. These transactions are completed on arm's length terms. There were no other related party transactions.

No amounts with any related parties were written off or foregone during the year (2016: Nil).

17. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES

Financial instruments

Financial instruments recognised in the Statement of Financial Position include cash and cash equivalents, short-term deposits, receivables and payables, and derivative financial instruments. The Group's policy is that no trading in financial instruments shall be undertaken.

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Financial assets are impaired when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The carrying amount of an asset is reduced through the use of a provision account, and the amount of the loss is recognised in the Income Statement. When a receivable is uncollectible, it is written off against the provision account for receivables. Subsequent recoveries of amounts previously written off are credited against the Income Statement.

Capital management

The capital structure of the Group consists of equity raised by the issue of ordinary shares in the Company. The Group manages its capital to ensure that entities in the Group are able to continue as going concerns. The Group is not subject to any externally imposed capital requirements.

Classification and fair values

Xero has carried out a fair value assessment of its financial assets and liabilities at 31 March 2017 in accordance with NZ IFRS 13 Fair Value Measurement.

The Group's hedging derivatives are recognised at fair value. Fair values are calculated using forward exchange rates that are quoted in an active market (level 2 on the fair value hierarchy).

The carrying value of the Group's other financial instruments do not materially differ from their fair value.

	Loans and receivables ($000s)	Hedging instruments at fair value ($000s)	Financial liabilities at amortised cost ($000s)	Total carrying value ($000s)
At 31 March 2017				
Assets				
Cash and cash equivalents	27,699	–	–	27,699
Term deposits	86,000	–	–	86,000
Trade and other receivables	29,435	–	–	29,435
Derivative assets	–	818	–	818
Total financial assets	**143,134**	**818**	**–**	**143,952**
Liabilities				
Trade and other payables	–	–	27,608	27,608
Derivative liabilities	–	2,414	–	2,414
Total financial liabilities	**–**	**2,414**	**27,608**	**30,022**

	Loans and receivables ($000s)	Hedging instruments at fair value ($000s)	Financial liabilities at amortised cost ($000s)	Total carrying value ($000s)
At 31 March 2016				
Assets				
Cash and cash equivalents	39,024	–	–	39,024
Term deposits	145,000	–	–	145,000
Trade and other receivables	20,635	–	–	20,635
Derivative assets	–	358	–	358
Total financial assets	**204,659**	**358**	**–**	**205,017**
Liabilities				
Trade and other payables	–	–	18,805	18,805
Derivative liabilities	–	3,983	–	3,983
Total financial liabilities	**–**	**3,983**	**18,805**	**22,788**

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, credit risk and foreign currency risk.

Interest rate risk

The Group's interest rate risk arises from its cash and cash equivalents, and short-term deposit balances. Cash and cash equivalents comprise cash in hand, deposits held at call with banks, and other short-term and highly liquid investments with original maturities of 90 days or less. Short-term deposits are initially reognised at fair value and are subsequently measured at amortised cost. Balances are placed on short-term deposit at fixed rates. At 31 March 2017 $66 million of short-term deposits had maturity dates within 6 months of balance date, the remainder with maturity dates between 6 and 12 months (2016: $93 million). The repricing of these exposes the Group to cash flow interest rate risk. The Group does not enter into interest rate hedges.

Management regularly reviews its banking arrangements to ensure that it achieves the best returns on its funds while maintaining access to necessary liquidity levels to service the Group's day-to-day activities.

The interest rate repricing profiles of the Group's financial assets and liabilities subject to interest rate risk are:

At 31 March 2017 if interest rates had been 1.0% higher/lower with all other variables held constant, the impact on the interest income, net loss and accumulated losses of the Group would have been $1,137,000 lower/higher (2016: $1,840,000). This analysis assumes that the cash and cash equivalents, and the short-term deposits balance were consistent with the year end balance throughout the year.

Liquidity risk

Liquidity risk is the risk that the Group cannot pay contractual liabilities as they fall due. At 31 March 2017 the Group held cash and cash equivalents of $27.7 million and term deposits of $86.0 million. The Group has sufficient liquidity to meet its cash flow requirements in the foreseeable future. The Group has no debt.

The undiscounted contractual cash flows of the Group's non-derivative financial liabilities are equal to the carrying value and are due within 18 months or less. The Group's exposure to undiscounted gross cash flows from derivative financial liabilities are:

	Carrying amount ($000s)	Contractual cash flows ($000s)	0-6 months ($000s)	6-12 months ($000s)	12-18 months ($000s)
At 31 March 2017					
Forward exchange contracts	2,414				
Inflows	–	95,402	56,351	31,968	7,083
Outflows	–	(97,668)	(57,853)	(32,716)	(7,100)
	2,414	**(2,266)**	**(1,502)**	**(748)**	**(17)**
At 31 March 2016					
Forward exchange contracts	3,983				
Inflows	–	84,634	40,765	43,869	–
Outflows	–	(89,175)	(43,139)	(46,036)	–
	3,983	**(4,541)**	**(2,374)**	**(2,167)**	–

Credit risk

Where the Group has a receivable from another party, there is a credit risk in the event of non-performance by that other party. Financial instruments that potentially subject the Group to credit risk principally consist of cash and cash equivalents, short-term deposits, derivatives and receivables.

The Group manages credit risk by placing cash and short-term deposits with high-quality financial institutions. The credit risk associated with trade receivables is small because of the inherently low individual transaction value and the spread over many customers.

Maximum exposure to credit risk at balance date

At 31 March	2017 ($000s)	2016 ($000s)
Cash and cash equivalents	27,699	39,024
Short-term deposits	86,000	145,000
Trade and other receivables	27,477	20,635
Derivative financial assets	818	358
Non-current receivables	1,958	2,004
Total	**143,952**	**207,021**

Foreign currency risk

The Group faces the risk of movements in foreign currency exchange rates in relation to the New Zealand Dollar. The Group has significant operations in three other currencies, being Great British Pounds (GBP), Australian Dollars (AUD) and United States Dollars (USD). As a result the Group's Income Statement and Statement of Financial Position are affected by movements in exchange rates.

The Group's exposure to foreign currency financial instruments is outlined below in New Zealand Dollars:

	AUD ($000s)	USD ($000s)	GBP (£000s)
At 31 March 2017			
Exposures			
Cash and cash equivalents	5,551	6,299	1,898
Trade and other receivables	4,999	1,469	2,418
Trade and other payables	(3,608)	(7,539)	(3,082)
Derivative financial instruments	(80,830)	44,974	(9,996)
Total foreign currency exposure from financial instruments	**(73,888)**	**45,203**	**(8,762)**
At 31 March 2016			
Exposures			
Cash and cash equivalents	4,970	12,730	4,512
Trade and other receivables	8,436	1,310	3,308
Trade and other payables	(2,726)	(3,034)	(2,443)
Derivative financial instruments	(42,925)	60,885	–
Total foreign currency exposure from financial instruments	**(32,245)**	**71,891**	**5,377**

Xero is exposed to currency risk from the operations of foreign subsidiaries and foreign currency denominated expenses in the Parent company. The significant exposure is USD outflows and AUD and GBP inflows. The Group's Treasury policy requires a portion of the next 18 months' cash flows to be hedged with forward exchange contracts, to reduce the impacts of short term movements in the exchange rate.

As at 31 March a movement of 10% in the New Zealand Dollar would impact the Income Statement and Statement of Changes in Equity (after hedging) as detailed in the table below:

	10% decrease		10% increase	
	2017 ($000s)	2016 ($000s)	2017 ($000s)	2016 ($000s)
Impact on:				
Net earnings before income tax	(3,244)	(1,894)	2,654	1,550
Equity (before income tax)	(7,770)	1,899	6,357	(1,554)

This analysis assumes a movement in the New Zealand Dollar across all currencies and only includes the effect of foreign exchange movements on monetary financial instruments. All other variables remain constant.

18. HEDGE ACCOUNTING

The Group uses derivatives in the form of forward exchange contracts (FECs) to reduce the risk that movements in exchange rates will affect the Group's New Zealand Dollar cash flows. These hedges have been designated as a hedge of highly probable forecast transactions (a cash flow hedge under NZ IAS 39: Financial instruments recognition and measurement). The Group's policy is to hedge a portion of the next 18 months' forecast cash flows.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are reclassified to the Income Statement in the periods when the hedged transaction affects profit and loss.

During the period, a hedging loss of $1,747,000 was recognised in other comprehensive income (2016: loss of $643,000). During the year, a loss of $3,776,000 was reclassified out of other comprehensive income to the Income Statement (2016: gain of $6,003,000). The remaining balance will be reclassified to the Income Statement in the 18 months following 31 March 2017.

Hedge position

At 31 March	**2017 Fair value ($000s)**	**2017 Notional amount hedged (NZD) ($000s)**	**2016 Fair value ($000s)**	**2016 Notional amount hedged (NZD) ($000s)**
Derivative assets				
Buy USD – Sell NZD	754	31,511	207	6,315
Buy NZD – Sell AUD	62	5,537	151	12,341
Buy NZD – Sell GBP	2	902	–	–
Total	**818**		**358**	
Derivative liabilities				
Buy USD – Sell NZD	(322)	13,194	(3,421)	58,420
Buy NZD – Sell AUD	(2,012)	73,470	(562)	30,241
Buy NZD – Sell GBP	(80)	9,082	–	–
Total	**(2,414)**		**(3,983)**	

19. CONTINGENCIES

There were no contingent liabilities at 31 March 2017 (2016: nil).

20. SHARE-BASED PAYMENTS

The Group operates equity-settled, share-based compensation plans, under which employees provide services in exchange for non-transferable options, Restricted Stock Units (RSUs) or shares. The value of the employee services rendered for the grant of non-transferable options, RSUs and shares is recognised as an expense over the vesting period, and the amount is determined by reference to the fair value of the options, RSUs and shares granted.

Employee Restricted Share Plan

The Xero Limited Employee Restricted Share Plan (RSP) exists for employees and executives of the Group. Under the RSP, ordinary shares in Xero Limited are issued to a trustee – Xero Trustee Limited, a wholly owned subsidiary – and allocated to participants, on grant date, using funds lent to them by the Company.

The shares are beneficially owned by the participants. The length of retention period before the shares vest is up to three years. If the individual is still employed by the Group at the end of each specific period, the employee is given a bonus that must be used to repay the loan and shares are then transferred to the employee. The weighted average grant date fair value of restricted shares issued during the year was $18.71 (2016: $17.44) and was determined by the volume weighted average price of Xero Limited shares for the 20 trading days preceding the grant date. Shares with a grant date fair value of $9,538,000 vested during the year (2016: $9,189,000). The Group has no legal or constructive obligation to repurchase the shares or settle the RSP for cash.

	2017 Number of shares (000s)	2016 Number of shares (000s)
Unvested shares at 1 April	608	607
Granted	622	615
Forfeited	(143)	(126)
Vested	(505)	(488)
Unvested shares at 31 March – allocated to employees	**582**	**608**
Forfeited shares not yet reallocated – held by trustee	52	65
Total	**634**	**673**
Ageing of unvested shares		
Balance of shares to vest within one year	378	274
Balance of shares to vest after one year	204	334
Total unvested shares at 31 March	**582**	**608**

The number of shares awarded pursuant to the RSP does not equal the number of shares created for the scheme, as forfeited shares are held in the trust and reissued.

Share Options Scheme

Options are granted to selected employees, Directors and service providers. The exercise price of the granted options is equal to the volume weighted average share price of Xero Limited shares for the 20 trading days preceding the grant date.

Options are conditional on completion of the necessary years' service (the vesting period) as appropriate to that tranche. The options' tranches vest over one to five years from the grant date. No options can be exercised later than the first anniversary of the final vesting date. There were 76 holders of options at 31 March 2017 (2016: 58).

The Group has no legal or constructive obligation to repurchase or settle the options in cash.

Movements in the number of options outstanding and their related weighted average exercise prices were as follows:

	2017 Weighted average exercise price ($)	2017 Options (000s)	2016 Weighted average exercise price ($)	2016 Options (000s)
Outstanding at 1 April	20.18	821	16.52	901
Granted	17.67	1,911	18.07	367
Forfeited	20.87	(410)	16.50	(259)
Exercised	8.26	(128)	3.73	(188)
Expired	5.31	(6)	–	–
Outstanding at 31 March	18.55	2,188	20.18	821
Exercisable at 31 March	24.66	249	21.60	305

Options outstanding at the end of the year had the following expiry dates and exercise prices:

Granted	Expiry date	Exercise price ($)	2017 Options (000s)	2016 Options (000s)
2012-13	2017-18	2.75	–	25
2012-13	2016-17	5.31	–	80
2012-13	2016-17	7.70	–	4
2013-14	2017-18	17.40	65	82
2013-14	2017-18	32.17	28	40
2013-14	2017-18	38.24	63	140
2014-15	2018-19	16.14	26	58
2014-15	2019-20	16.85	–	25
2015-16	2019-20	19.51	176	176
2015-16	2019-20	17.14	–	125
2015-16	2019-20	16.00	29	66
2016-17	2019-20	17.51	30	–
2016-17	2021-22	17.51	1,480	–
2016-17	2021-22	19.50	60	–
2016-17	2020-21	19.50	11	–
2016-17	2021-22	18.52	40	–
2016-17	2021-22	17.89	120	–
2016-17	2021-22	18.81	60	–
			2,188	**821**

The weighted average fair value of options granted during the year, determined using the Black-Scholes valuation model, was $6.44 per option (2016: $5.45).

The significant inputs into the model were the volume weighted average market share price of Xero Limited for the 20 trading days preceding grant date, the exercise price shown above, the expected annualised volatility of between 37% and 45%, a dividend yield of 0%, an expected option life of between two and five years and an annual risk-free interest rate of between 2.0% and 2.5%.

The volatility measured is the standard deviation of continuously compounded share returns and is based on a statistical analysis of daily share prices in the past two to five years.

Restricted Stock Units

RSUs are issued to certain employees and executives of the Group. On the grant date an RSU agreement is entered into between employee and Company stipulating the number of units granted and their vesting schedules. On the vest date the RSUs are converted to ordinary shares.

No cash consideration is required to be paid to exercise the RSUs. The fair value of RSUs granted in the year ended 31 March 2017 was $5,597,000 (2016: $7,166,000) as determined by the volume weighted average share price. The RSUs are conditional on the employees completing up to three years' service (the vesting period) and are for the most part, exercisable in equal amounts over the vesting period.

	2017 Weighted average exercise price ($)	2017 RSUs (000s)	2016 Weighted average exercise price ($)	2016 RSUs (000s)
Outstanding at 1 April	17.30	705	17.68	531
Granted	18.72	299	16.94	423
Forfeited	18.15	(156)	17.10	(175)
Converted to shares	17.64	(349)	18.06	(69)
Surrendered to pay payroll tax	17.59	(172)	24.09	(5)
Outstanding at 31 March	**17.41**	**327**	**17.30**	**705**

The Company withholds shares under certain circumstances to settle tax obligations on vesting. Based on the current market share price, future cash payments to meet tax obligations are expected to be $2,384,000.

21. COMMITMENTS

Operating lease commitments

The Group leases office space and motor vehicles under non-cancellable operating lease agreements. The lease terms are between 1 and 12 years. A number of lease agreements are renewable at the end of the lease periods at a market rate.

The future minimum lease payments under non-cancellable operating leases are as follows:

At 31 March	2017 ($000s)	2016 ($000s)
Within one year	9,647	8,112
After one year but not more than five years	34,025	31,588
More than five years	17,914	23,323
	61,586	**63,023**

Xero leases a property that has been sublet as it is surplus to requirements. The lease and sublease are on equivalent terms.

The total future minimum sublease payments expected to be received under non-cancellable subleases for office space at 31 March 2017 is $1,323,000 (2016: $1,920,000).

Capital commitments

Capital commitments of $9,434,000 for building fitouts and software purchases were contracted for at 31 March 2017 but not yet incurred (2016: $3,950,000).

22. GROUP ENTITIES

Consolidation subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions and balances between Group companies are eliminated on consolidation.

The financial statements of each of the Group's subsidiaries are prepared in the functional currency of that entity. The functional currency is determined for each entity based on factors such as the principal trading currency. The assets and liabilities of these entities are translated at exchange rates existing at balance date. Revenue and expenses are translated at rates approximating the exchange rates ruling at the dates of the transactions. The exchange gains or losses arising on translation are recorded in other comprehensive income and accumulated in the foreign currency translation reserve in equity.

	Principal activity	Country of incorporation	Balance date	Interest 2017 (%)	Interest 2016 (%)
Xero (NZ) Limited	Reseller	New Zealand	31 March	100	100
Xero (UK) Limited	Reseller	United Kingdom	31 March	100	100
Xero Australia Pty Limited	Reseller	Australia	31 March	100	100
Xero, Inc.	Reseller	United States	31 March	100	100
Xero (Singapore) Pte. Ltd	Service provider	Singapore	31 March*	100	100
Monchilla, Inc.	Payroll software	United States	31 December	100	100
Xero Trustee Limited	Trustee	New Zealand	31 March	100	100

**Balance date was changed from 31 December to 31 March during the year ended 31 March 2017*

23. EVENTS AFTER THE BALANCE SHEET DATE

There were no significant events between balance date and the date these financial statements were authorised for issue.

Directors' Responsibilities Statement

The Directors are required to prepare financial statements for each financial year that present fairly the financial position of the Group and its operations and cash flows for that period.

The Directors consider that these financial statements have been prepared using accounting policies suitable to the Group's circumstances, which have been consistently applied and supported by reasonable judgements and estimates, and that all relevant financial reporting and accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy, at any time, the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1993. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Board of Directors of the Company authorised these financial statements for issue on 11 May 2017.

For and on behalf of the Board of Directors

Graham Smith
Chair
Xero Limited
11 May 2017

Lee Hatton
Director
Xero Limited
11 May 2017

Corporate Governance

The Board recognises the importance of good corporate governance, particularly its role in delivering improved corporate performance and protecting the interests of all stakeholders.

The Board is responsible for establishing and implementing the Company's corporate governance frameworks, and is committed to fulfilling this role in accordance with best practice while observing applicable laws and the NZX Corporate Governance Best Practice Code (NZX Code).

This section sets out the Company's commitment to good corporate governance and addresses the Company's compliance with the NZX Code, using the structure of the nine principles published in the *Corporate Governance in New Zealand – Principles and Guidelines* issued by the Financial Markets Authority (FMA Principles).

PRINCIPLE 1 – ETHICAL STANDARDS

Directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation.

The Board maintains high standards of ethical conduct and the Chief Executive and broader management team are responsible for ensuring that high standards of ethical conduct are maintained by all staff. Employees are made aware of, and required to comply with, the Company's Code of Conduct.

The Code of Conduct is available in the Investors section of the Company's website, and covers: the practices necessary to maintain confidence in the Company's integrity; the practices necessary to take into account the Company's legal obligations and reasonable expectations of its stakeholders; and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Conflicts of interest The Board Charter (available in the Investors section of the Company's website) outlines the Board's policy on conflicts of interest. If conflicts of interest exist, Directors do not exercise their right to vote on such matters. An Interests Register is maintained to record any interests that have been disclosed by Directors.

The particulars of entries made in the Interests Register for the period 1 April 2016 to 31 March 2017 are set out in the Disclosures section of this Annual Report.

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE

To ensure an effective board, there should be a balance of independence, skills, knowledge, experience and perspectives.

The Board is the overall and final body responsible for all decision-making within the Company, having a core objective to effectively represent and promote the interests of shareholders with a view to adding long term value to the Company.

The Board Charter describes the Board's role and responsibilities and regulates internal Board procedures; this document is available in the Investors section of the Company's website.

The Board directs, and supervises the management of, the business and affairs of the Company including, in particular:

- ensuring that the Company's goals are clearly established, and that strategies are in place for achieving them;
- ensuring that there is an ongoing review of performance against the Company's strategic objectives;
- approving transactions relating to acquisitions and divestments, and capital expenditure above delegated authority limits;
- ensuring that there is ongoing assessment of business risks and that there are appropriate control and accountability systems in place to manage them;
- establishing policies aimed at strengthening the performance of the Company, including ensuring that management proactively seeks to build the business through innovation, initiative, technology, new products, and the development of its business capital;
- monitoring the performance of management;
- appointing the Chief Executive, setting the terms of their employment and, where necessary, terminating their employment; and
- approving and monitoring the Company's financial and other reporting and ensuring the Company's financial statements represent a true and fair view.

Delegation To enhance efficiency, the Board has delegated some of its powers to Board Committees and other powers to the Chief Executive. The terms of the delegation by the Board to the Chief Executive are documented in the Board Charter and are set out in the Company's Delegated Authority Framework. This framework also establishes the authority limits for decision-making within the Company's management team.

Composition of the Board The Board is comprised of experienced individuals based in New Zealand, Australia, and the U.S., with a broad and diverse range of technology, financial, sales, legal, and general business experience. At 31 March 2017, the Board comprised seven Directors as follows:

- Graham Smith (Non-executive Chair)
- Rod Drury (Executive Director)
- Craig Elliott (Non-executive Director)
- Lee Hatton (Non-executive Director)
- Susan Peterson (Non-executive Director)
- Bill Veghte (Non-executive Director)
- Craig Winkler (Non-executive Director)

A short biography of each Director is available at www.xero.com/about/investors/leadership.

Sam Morgan retired as a Non-executive Director at the 2016 Annual Meeting on 20 July 2016, and Chris Liddell resigned as a Non-executive Director and Chair of the Board effective 20 January 2017. Susan Peterson was appointed as a Non-executive Director effective 22 February 2017.

Selection and role of Chair The Chair of the Board is elected by the Non-executive Directors. The Board supports the separation of the roles of Chair of the Board and the Chief Executive.

The Chair's role is to manage the Board effectively, to provide leadership to the Board, and to facilitate the Board's interface with the Chief Executive.

Graham Smith, the current Chair of the Board, was appointed to that role effective 20 January 2017. The Board has determined that Graham Smith is an Independent Director.

Director independence The Board Charter requires that a minimum of two Directors be independent.

The Board takes into account the guidance provided under the NZX Listing Rules in determining the independence of Directors.

The Board will review any determination it makes as to a Director's independence on becoming aware of any information that may have an impact on the independence of the Director. For this purpose, Directors are required to ensure that they immediately advise the Board of any relevant new or changed relationships to enable the Board to consider and determine the materiality of the relationships. The Interests Register is maintained to record these relationships.

As at 31 March 2017, the Board considers that Graham Smith, Craig Elliott, Lee Hatton, Susan Peterson, and Bill Veghte are Independent Directors. The Board has determined that Rod Drury is not an Independent Director because of his executive responsibilities and substantial shareholding, and that Craig Winkler is not an Independent Director because of his substantial shareholding.

Nomination and appointment The procedures for the appointment and removal of Directors are ultimately governed by the Company's Constitution.

The Nominations Committee and its role is discussed further in Principle 3.

In accordance with NZX Listing Rules, the Company communicates through the ASX and NZX market announcement platforms that it accepts nominations for Directors, with such nominations to be considered by shareholders at the Company's Annual Meeting.

Directors receive formal letters of appointment setting out the arrangements relating to their appointment.

Retirement and re-election The Board acknowledges and observes the relevant Director rotation/retirement rules under the Company's Constitution and the NZX Listing Rules, meaning that the prescribed number of Directors, at a minimum, retire at the Company's Annual Meeting. These individuals may offer themselves for re-election as Directors at the Annual Meeting at which they retire by rotation.

Board access to information and advice Directors have the ability to access Group records and information required to fulfil their roles as Directors. All Directors have access to the senior management team, including the Company Secretary, to discuss issues or obtain information on specific areas in relation to items to be considered at Board meetings or other areas as they consider appropriate.

The Company Secretary is responsible for supporting the effectiveness of the Board by ensuring that policies and procedures are followed and coordinating the completion and dispatch of Board agendas and papers.

The Board, the Board Committees, and each Director have the right, subject to the approval of the Chair, to seek independent professional advice at the Company's expense to assist them to carry out their responsibilities. Further, the Board and Board Committees have the authority to secure the attendance at meetings of outsiders with relevant experience and expertise.

Director education All Directors are responsible for ensuring they remain current in understanding their duties as Directors.

Directors' share ownership Directors are encouraged to hold shares in the Company. All Directors and employees are required to comply with the Company's Securities Trading Policy and Guidelines in undertaking any trading in the Company's shares. This policy can be found in the Investors section of the Company's website. A table of Directors' equity holdings in the Company is included in the Disclosures section of this Annual Report.

Indemnities and insurance Deeds of indemnity have been granted by the Company in favour of the Directors in relation to potential liabilities and costs they may incur for acts or omissions in their capacity as Directors.

The Directors and Officers liability insurance covers risks customarily covered by such policies arising out of acts or omissions of Directors and employees in their capacity as such.

Board meetings The Board met nine times during the financial year, where key financial and operational matters were considered as well as matters of strategic importance. The Board also approves certain matters by way of circular resolution, such as issues of equity under the Company's long term incentive (LTI) schemes.

Executives regularly attend Board meetings and are also available to be contacted by Directors between meetings.

There were also separate meetings of the Board Committees during the year as necessary. Directors who are not members of the Committees may attend the Committee meetings.

Board performance The Board has a formal review of performance and areas of focus on an annual basis, addressing individual Director, Board, and Committee performance.

PRINCIPLE 3 – BOARD COMMITTEES

The board should use committees where this will enhance its effectiveness in key areas, while still retaining board responsibility.

Board Committees The Board operates three Committees: the Audit and Risk Management Committee, the People and Remuneration Committee, and the Nominations Committee. The Charter of each Committee is in the Investors section of the Company's website.

The membership of each Committee at 31 March 2017 was:

- Audit and Risk Management Committee: Lee Hatton (Chair), Craig Winkler, Graham Smith
- People and Remuneration Committee: Bill Veghte (Chair), Craig Elliott, Lee Hatton
- Nominations Committee: Graham Smith (Chair), Craig Winkler, Bill Veghte

Susan Peterson was appointed to the People and Remuneration Committee effective 20 April 2017.

Audit and Risk Management Committee Please see Principle 4 for further details on the Audit and Risk Management Committee.

People and Remuneration Committee Please see Principle 5 for further details on the People and Remuneration Committee.

Nominations Committee The Board has established a Nominations Committee whose role is to identify and recommend to the Board individuals for nomination as members of the Board and Board Committees, taking into account such factors as it deems appropriate, including independence, skills, knowledge, experience, and perspectives.

PRINCIPLE 4 – REPORTING AND DISCLOSURE

The board should demand integrity in financial reporting and in the timeliness and balance of corporate disclosures.

The Board is committed to a transparent system for auditing and reporting of the Company's financial performance. The Board has established an Audit and Risk Management Committee, which performs a central role in achieving this goal. All members of the Audit and Risk Management Committee must have appropriate financial experience and at least one member must have an accounting or financial background. The Committee is comprised solely of Non-executive Directors.

The Audit and Risk Management Committee's principal functions are:

- to assist the Board in ensuring that appropriate accounting policies and internal controls are established and followed;
- to assist the Board in producing accurate financial statements in compliance with all applicable legal requirements and accounting standards; and
- to ensure the efficient and effective management of business risks.

The Audit and Risk Management Committee has adopted a formal Charter, which is available in the Investors section of the Company's website.

Corporate disclosures The Company's Market Disclosure Communications Policy is available in the Investors section of the Company's website.

The Company complies with its continuous disclosure obligations, including under the NZX Listing Rules, the Financial Markets Conduct Act 2013, and the ASX Listing Rules.

PRINCIPLE 5 – REMUNERATION

The remuneration of directors and executives should be transparent, fair and reasonable.

The Board has a People and Remuneration Committee whose principal function is to oversee the Company's strategies and policies relating to organisational structure, culture, employee performance and development, succession planning, growth, and remuneration. The People and Remuneration Committee is governed by a formal charter, which is available in the Investors section of the Company's website.

In order to align employee interests with shareholders, the Company's remuneration policy and practice is based on maintaining remuneration principles that:

- differentiate and reward excellent performance and key talent, both in the short and long term, and recognise the Company's values;
- enable the Company to attract and retain employees, and motivate them to achieve results with integrity and fairness, while being market-competitive;
- balance the mix of fixed and variable compensation to reflect the value and responsibility of a role, and influence appropriate behaviours and actions to support a growing business;
- focus on a flexible approach, recognising that key employees, their roles, and the market in which they operate are unique;
- ensure that performance objectives linked to remuneration are aligned to the Company's overall strategy;
- foster teamwork and collaboration across the Company and in particular at the executive level;
- take into account the long term performance of the Company, in order to create sustainable value for shareholders;
- ensure identifying characteristics have no influence on employees' remuneration, whether they be gender, race, religion, or factors other than performance, experience, education, knowledge, and size or scope of the role; and
- are regularly reviewed, updated and approved by the Company's People and Remuneration Committee.

Director remuneration Directors' fees are currently set at a maximum of $850,000 for the Non-executive Directors. The total amount of remuneration and the value of other benefits received by the Directors in the financial year is set out in the Disclosures section of this Annual Report, along with further detail on remuneration paid to Directors. The Company distinguishes the structure of Non-executive Directors' remuneration from that of its Executive Director.

Performance management Formal procedures are in place to evaluate the performance of all of the Company's employees. This process is managed by the Chief People Officer in liaison with the Chief Executive and the Chief Executive's direct reports as appropriate. This process was completed for the financial year.

Evaluations of the Chief Executive and the executive team are based on defined criteria, including the performance of the Company and individual performance, and the accomplishment of long term strategic objectives and other non-quantitative objectives. Performance evaluations of the Chief Executive and executive team for the financial year were completed as planned.

The People and Remuneration Committee has responsibilities that include reviewing and evaluating the performance of the Chief Executive against key performance objectives, reviewing the performance objectives for the Chief Executive for the following year, and monitoring the performance of each of the Chief Executive's direct reports.

Employee incentives A key component of the Company's remuneration framework is the Company's LTI schemes, which are generally available to all employees. These schemes allow employees to be granted shares (or equity that is convertible to shares) in the Company, which aligns the interests of those employees with the interests of shareholders and rewards participating employees for the creation of shareholder wealth.

Senior management also participate in a short term incentive (STI) scheme, with remuneration under this scheme determined by the achievement of key performance indicators that are individually set for the participants in the scheme.

PRINCIPLE 6 – RISK MANAGEMENT

Directors should have a sound understanding of the key risks faced by the business, and should regularly verify there are appropriate processes to identify and manage these.

As noted in Principle 4, one of the principal functions of the Audit and Risk Management Committee is to ensure the efficient and effective management of business risks.

The Company's senior management maintain a Risk Register which is reviewed at Audit and Risk Management Committee meetings, with certain aspects escalated to the Board as appropriate by the Audit and Risk Management Committee. Detailed reviews of certain risks appearing on the Risk Register are undertaken at Audit and Risk Management Committee meetings, as appropriate.

The Company also maintains a Delegated Authority Framework to outline the authority limits and powers delegated by the Board to the Chief Executive, management team, and employees of the Group. The Delegated Authority Framework is reviewed annually.

The Company has internal controls to identify and monitor risk, managed within the Company's finance team and by the Chief Operating and Financial Officer and the Chief Accounting Officer.

PRINCIPLE 7 – AUDITORS

The board should ensure the quality and independence of the external audit process.

Another purpose of the Audit and Risk Management Committee is to ensure the quality and independence of the audit process. The Chair of the Audit and Risk Management Committee and the Chief Accounting Officer work with the external auditors to plan the audit approach. All aspects of the audit are reported back to the Audit and Risk Management Committee and the auditors are given the opportunity at Audit and Risk Management Committee meetings to meet with the Committee, including without the Company's management being present.

The external auditors are responsible for planning and carrying out each audit and review, in accordance with applicable auditing and review standards. The Board ensures the auditor is remunerated fairly for the agreed scope of the statutory audit and audit-related services.

Non-audit work During the financial year, the external auditors did specific non-audit work (see note 6 to the financial statements), with approval from the Audit and Risk Management Committee. There was no compromise to the independence and objectivity of the audit process as a result of such specific non-audit work.

See Principle 4 for further detail about financial reporting and the role of the Audit and Risk Management Committee.

PRINCIPLE 8 – SHAREHOLDER RELATIONS

The board should foster constructive relationships with shareholders that encourage them to engage with the entity.

During the time that the Company has been listed on the NZX and the ASX, it has built a reputation of openness and has encouraged a high level of communication with shareholders and the market generally. It does this through numerous forms of communication including formal communication, social media, blogs, press releases, and roadshows.

The Board encourages active participation by shareholders at the Annual Meeting of the Company, and allows shareholders to submit questions to the Board prior to or at the Annual Meeting.

The Board also facilitates questions to the external auditors during the Annual Meeting.

The Company maintains an up-to-date website providing a description of the business and links to key corporate governance documents.

PRINCIPLE 9 – STAKEHOLDER INTERESTS

The board should respect the interests of stakeholders, taking into account the entity's ownership type and its fundamental purpose.

The Company has a wide range of stakeholders and aims to manage its business in a way which builds sustainable value and produces positive outcomes for stakeholders.

Community The Company is involved in sponsorship and volunteering in the wider community.

The Company has collaborated with a number of organisations to provide mentorship and guidance to support business growth to a number of startups such as BizDojo Wellington, The Icehouse, and Enterprise Nation, a United Kingdom small business community that helps people grow their own successful businesses. The Company's mentors come from a range of backgrounds, with knowledge and experience in building scalable products, overseas markets, product roadmaps, and team building.

The Company also champions the development of Science Technology Engineering and Math (STEM) careers in local communities around the world, via sponsorship and employees giving their time to causes. In Australia these include the Company's Vacation Program, Code the Future, and Tech Girls Movement, and in New Zealand these include Summer of Tech, Enspiral Dev Academy, JHack, Code Camp Wellington, Software Engineering Students Association, ShadowTech, OMGTech!, GirlBoss and Futureintech. In the United Kingdom, these include Girl Geek events and an annual entrepreneur scholarship program for students. In the United States, the Company's employees volunteered at the San Francisco Food Bank and assisted with canned food and toy drives. The Company has also supported La Cocina, an organisation based out of San Francisco that helps female food entrepreneurs.

The Company has its own graduate and intern programs that support junior talent entering the technology industry. These programs are in place to develop the Company's own internal talent but also reflect the Company's commitment to the community, addressing youth unemployment, and helping to develop the technology industry.

Diversity and inclusion The Company is focussed on ensuring it has a diverse and inclusive workplace, as this benefits employees and drives stronger business outcomes. Led by the executive team, diversity and inclusion is one of the Company's strategic priorities.

The Board has approved measurable objectives focussing on diversity and inclusion. These are set out below, along with the Company's progress towards achieving them.

Objective A: Ensure that all recruitment campaigns generate a diverse pool of talent and that all hiring decisions are based on merit, taking into account the relevant skills, qualifications, and experience of all applicants and recognising the importance of diversity in the workforce.

Progress: The Company actively seeks to attract a diversity of people using a range of recruitment tools and channels, and diverse and inclusive language and images, to ensure engagement with a greater breadth of people talent. Selection processes are rigorous, involving screening, interviewing, and competency based testing, so that hiring decisions are appropriately focused on diversity as well as being merit based. Relevant employees receive training and communications about diversity and inclusion, including how to address impediments to diversity such as unconscious bias.

To attract a more gender diverse workforce and support the technology community, the Company hosts and supports initiatives including Geek Girl Dinners, International Women's Day events, Code Like A Girl, Tech Girls Movement, and Diverse City Careers.

Objective B: Ensure that appropriate internal policies supporting and promoting diversity have been adopted and are well communicated to all employees.

Progress: The Company has adopted and communicated to its employees a Diversity Policy and a Code of Conduct, both of which support diversity and inclusion in the workplace, and are available on the Company's intranet and in the Investors section of the Company's website.

The Company has recently updated and communicated to all employees its Flexible Working Guidelines. Flexible working arrangements may include part-time work, flexible working hours, working from home, and job-sharing arrangements.

Objective C: Ensure that no impediments exist that restrict the ability to maintain a diverse workforce.

Progress: In the past 12 months the Company has undertaken a robust diversity and inclusion review to uncover any impediments to maintaining a diverse and inclusive workplace and highlight any opportunities to strengthen diversity and inclusion.

A diversity and inclusion strategy has been developed and includes the following key initiatives:

- appointment of a Diversity and Inclusion Manager (commencing in May 2017) to drive the Company's strategy and implementation of initiatives;
- design and delivery (currently underway) of ongoing diversity and inclusion training for all employees, including within existing leadership training programs;
- assessing and removing roadblocks to greater gender diversity at senior leadership levels;
- implementation of an ongoing internal communications plan to all employees to educate and promote the importance of diversity and inclusion; and
- incorporation of diversity and inclusion in the Company's external communications, brand activities, and in the articulation of the Company's employee value proposition.

The Company also fosters a transparent and open culture that enables and encourages employees to provide candid feedback about diversity and inclusion, including through anonymous employee engagement surveys.

Objective D: Continually review and monitor parity of working conditions and pay across the workforce.

Progress: The Company regularly reviews the working conditions of all employees, and reviews remuneration to ensure that it is merit-based and adequately reflects the responsibilities of the position. The Company's annual performance and salary reviews provide visibility to management about parity of working conditions and pay. The Company conducts separate annual analyses comparing remuneration across genders, and comparing remuneration of employees in the same role and with the same experience, and acts to rectify discrepancies identified. There are numerous ways in which employees can raise concerns about working conditions within the Company, and these are communicated to employees.

Objective E: Reinforce internally and externally that Xero is an equal opportunity employer that does not discriminate on any of the prohibited grounds of discrimination, including gender, family status, sexual orientation, religious, ethical or political beliefs, ethnicity, disability, and age.

Progress: The composition of the Company's workforce demonstrates that it is an equal opportunity employer that does not discriminate on any of the prohibited grounds of discrimination. Relevant regional policies address equal employment opportunity and have been communicated to employees.

Gender diversity The Company has achieved approximately 39% female gender balance across its workforce, which is higher than average for comparable companies in the technology industry. The proportion of females employed by the Group was as follows:

At 31 March	2017 Female	2017 Male	2017 Total	2017 %	2016 Female	2016 Male	2016 Total	2016 %
Directors	2	5	7	29%	1	7	8	13%
Officers*	4	8	12	33%	–	6	6	0%
All employees	651	1,028	1,681**	39%	538	915	1,454	37%

These figures include headcount numbers for permanent full-time, permanent part-time, and fixed-term employees, but not contractors
**Officer is defined as a person who is concerned or takes part in the management of the Company and reports directly to the Board or reports directly to a person who reports to the Board. The Company's Officers are the Chief Executive and all direct reports to the Chief Executive. Due to changes in reporting lines during the financial year, individuals included as "Senior Executives" in the Company's 2016 Annual Report are now included as Officers for the purpose of this disclosure. Last year, the Company disclosed no female Officers, but had two female Senior Executives (17% of the Senior Executives)*
*** The Company has an optional self-selection gender identification question that allows employees to choose from the following options: female, male, and not declared. Employees can also leave this question unanswered. Two employees selected not declared and are included in the total. 64 employees were excluded from the total because they did not respond to the gender identification question. If these 64 employees were included in the total number of employees and not assigned a gender, the proportion of females of that total would be 37%*

Disclosures

ENTRIES RECORDED IN THE INTERESTS REGISTER

The Company maintains an Interests Register in accordance with the Companies Act 1993 and the Financial Markets Conduct Act 2013. The following are particulars of entries made in the Interests Register for the period 1 April 2016 to 31 March 2017.

Directors' interests Directors disclosed interests, or cessations of interest, in the following entities pursuant to section 140 of the Companies Act 1993 during the year ended 31 March 2017.

Director/Entity	Relationship
Craig Winkler	
VWork Limited	Investor
Marketboomer Holdings Pty Ltd	Investor
myprosperity Aust Pty Ltd	Investor
Graham Smith	
BlackLine Inc.	Minority Shareholder
Splunk, Inc.	Increased Minority Shareholding

Director/Entity	Relationship
Susan Peterson	
Trustpower Limited	Director
Vista Group International Limited	Director
Organic Initiative Limited	Director and Co-Chairman
Property For Industry Limited	Director
The New Zealand Merino Company Limited	Director
NZ Markets Disciplinary Tribunal	Tribunal Member

Share dealings of Directors Directors disclosed the following acquisitions and disposals of relevant interests in the Company's shares during the year ended 31 March 2017.

Shares	Date of acquisition/disposal	Consideration per share	Number of shares acquired/ (disposed)
Lee Hatton*	10 August 2016	$19.41	1,803
Lee Hatton*	10 February 2017	$18.81	2,154
Chris Liddell**	10 February 2017	$19.08	(15,000)
Chris Liddell***	17 February 2017	$16.14	21,442
Chris Liddell****	17 February 2017	$16.00	12,304
Chris Liddell*****	20 February 2017	AUD17.84	(1,134)
Chris Liddell******	21 February 2017	AUD17.55	(5,390)
Chris Liddell*******	22 February 2017	AUD17.52	(5,731)
Chris Liddell********	23 February 2017	AUD17.55	(21,491)

** The shares were issued to Lee Hatton as remuneration for her role as Director*
*** Chris Liddell resigned as a Director effective 20 January 2017. The 15,000 shares (held by FNZ Custodians Limited (on behalf of Chris Liddell)) were disposed of at an average price of $19.08 per share (ranging from $19.08 to $19.10 per share)*
**** The shares were issued upon exercise of an equivalent number of options. Each option had an exercise price of $16.14*
***** The shares were issued upon exercise of an equivalent number of options. Each option had an exercise price of $16.00*
****** The shares were disposed of at an average price of AUD17.84 per share (ranging from AUD17.75 to AUD17.85 per share)*
******* The shares were disposed of at an average price of AUD17.55 per share (ranging from AUD17.50 to AUD17.70 per share)*
******** The shares were disposed of at an average price of AUD17.52 per share (ranging from AUD17.48 to AUD17.62 per share)*
********* The shares were disposed of at an average price of AUD17.55 per share (ranging from AUD17.34 to AUD17.73 per share)*

Holdings of shares and options by Directors

At 31 March	2017 Number of shares	2017 Number of options	2016 Number of shares	2016 Number of options
Rod Drury	20,719,779	–	20,719,779	–
Craig Elliott*	100,000	–	100,000	–
Sam Morgan**	4,122,609	–	4,622,609	–
Craig Winkler (two holdings)	17,475,990	–	17,475,990	–
Chris Liddell***	–	–	15,000	147,556
Bill Veghte****	41,321	118,045	41,321	118,045
Lee Hatton*****	10,223	–	6,266	–
Graham Smith	–	–	–	–
Susan Peterson	–	–	–	–

** The shares are held by Private Nominees Limited as custodian for the benefit of Craig Elliott*
*** Sam Morgan retired as a Director at the 2016 Annual Meeting on 20 July 2016*
**** Chris Liddell resigned as a Director effective 20 January 2017. As a result of Chris Liddell's resignation, 113,810 unexercised options were forfeited on 17 February 2017*
***** 89,782 of the options granted to Bill Veghte have vested (meaning that they are capable of being exercised) as at 12 February 2017. None of the options have been exercised as at 28 April 2017. The 41,321 shares are held by National Financial Services LLC on behalf of Bean Brook Farm 2013 Annuity Trust (the Trust). Bill Veghte is the trustee of the Trust and his immediate family are the beneficiaries. 15,321 of the shares are held in the form of securities purchased in the U.S. through the OTC Markets as "XROLF"*
****** Lee Hatton was issued shares in lieu of cash, as remuneration for her role as Director. In addition to the 10,223 shares held by Lee Hatton (as noted above), 200 shares are held by Lee Hatton's spouse*

Remuneration of Directors Details of the total remuneration of, and the value of other benefits received by, each Director of the Company during the financial years ended 31 March:

	2017 Fees ($000s)	2017 Remuneration ($000s)	2016 Fees ($000s)	2016 Remuneration ($000s)
Rod Drury*	–	731	–	761
Craig Elliott	57	–	40	–
Sam Morgan**	13	–	40	–
Graham Shaw***	–	–	15	–
Craig Winkler	57	–	40	–
Chris Liddell****	(136)	–	202	–
Bill Veghte*****	185	–	161	–
Lee Hatton	81	–	72	–
Graham Smith	220	–	226	–
Susan Peterson******	9	–	–	–
Total	**486**	**731**	**796**	**761**

** Rod Drury is an Executive Director and receives remuneration from the Company in the form of a salary and STI (if applicable). He does not participate in the Employee Restricted Share Plan or receive remuneration in his capacity as Director*
*** Sam Morgan retired as a Director at the 2016 Annual Meeting on 20 July 2016*
**** Graham Shaw resigned as a Director at the 2015 Annual Meeting on 22 July 2015*
***** Chris Liddell resigned as a Director effective 20 January 2017. The 2017 figure represents the accounting expense that has been recognised for the financial year ended 31 March 2017 in respect of the options granted to Chris Liddell in his capacity as Director. As a result of Chris Liddell's resignation, unexercised options were forfeited resulting in a net credit, relating to costs recognised in prior years being reversed in the Income Statement*
****** The 2017 figure represents the accounting expense that has been recognised for the financial year ended 31 March 2017 in respect of the options granted to Bill Veghte in his capacity as Director. Due to the three year vesting of the options, the current year expense includes options granted in 2015 and 2016; (2016: expense includes options granted in 2014, 2015 and 2016)*
******* Susan Peterson was appointed as a Non-executive Director effective 22 February 2017*

Employee remuneration The following table shows the number of employees of the Group (including employees holding office as Directors of subsidiaries) whose remuneration and benefits for the year ended 31 March 2017 were within the specified bands above $100,000. The numbers below include 354 New Zealand-based current and former employees and 453 overseas-based current and former employees.

The remuneration covered in the table below includes: monetary payments; share-based payments (i.e. shares, restricted stock units, and vested and unvested options, including options granted during the year); and compensation relating to departed employees.

The table below includes the remuneration of Rod Drury ($731,000).

Remuneration including share-based compensation	2017 Number of employees
100,000 to 109,999	115
110,000 to 119,999	98
120,000 to 129,999	88
130,000 to 139,999	80
140,000 to 149,999	79
150,000 to 159,999	45
160,000 to 169,999	43
170,000 to 179,999	39
180,000 to 189,999	24
190,000 to 199,999	25
200,000 to 209,999	19
210,000 to 219,999	19
220,000 to 229,999	15
230,000 to 239,999	17
240,000 to 249,999	16
250,000 to 259,999	9
260,000 to 269,999	4
270,000 to 279,999	6
280,000 to 289,999	5
290,000 to 299,999	2
300,000 to 309,999	4
310,000 to 319,999	4
320,000 to 329,999	4
340,000 to 349,999	1
350,000 to 359,999	4
360,000 to 369,999	1
380,000 to 389,999	1
390,000 to 399,999	1

Remuneration including share-based compensation	2017 Number of employees
400,000 to 409,999	3
430,000 to 439,999	3
450,000 to 459,999	1
460,000 to 469,999	1
480,000 to 489,999	1
490,000 to 499,999	3
510,000 to 519,999	4
530,000 to 539,999	1
540,000 to 549,999	1
570,000 to 579,999	1
610,000 to 619,999	2
620,000 to 629,999	1
630,000 to 639,999	1
640,000 to 649,999	1
650,000 to 659,999	1
660,000 to 669,999	1
680,000 to 689,999	1
710,000 to 719,999	1
730,000 to 739,999	2
760,000 to 769,999	1
780,000 to 789,999	1
880,000 to 889,999	1
920,000 to 929,999	1
1,100,000 to 1,109,999	1
1,570,000 to 1,579,999	1
1,940,000 to 1,949,999	1
2,430,000 to 2,439,999	2

Analysis of shareholding at 28 April 2017

	Number of holders	Number of shares	% of issued capital
1 to 1,000	12,772	4,245,148	3.08
1,001 to 5,000	2,802	6,140,928	4.46
5,001 to 10,000	412	2,956,593	2.15
10,001 to 100,000	323	7,703,940	5.59
100,001 and over	43	116,714,527	84.72
Total	**16,352**	**137,761,136**	**100.00**

There were 132 shareholders on the Company's New Zealand register holding less than a "minimum holding" (defined in the NZX Listing Rules as 25 shares) on 28 April 2017. There were also 315 shareholders on the Company's Australian register holding less than a marketable parcel of shares (defined in the ASX Listing Rules as a parcel of not less than AUD500), based on the closing price of the Company's shares on the ASX on 28 April 2017, being AUD20.00.

There was, at the date of this Annual Report (11 May 2017), no on-market buy-back for the Company's shares.

Twenty largest shareholders at 28 April 2017

Shareholder rank and name	Holding	% of total shares on issue
1. New Zealand Central Securities Depository Limited	44,469,805	32.28
2. Anna Margaret Clare Drury and Rodney Kenneth Drury and Scott Moran (Rod Drury)	20,719,779	15.04
3. Givia Pty Limited (Craig Winkler)	17,454,545	12.67
4. AP Investments (HK) Limited	6,643,636	4.82
5. Valar Ventures LP (Peter Thiel)	4,135,870	3.00
6. Jasmine Investment Holdings Limited (Sam Morgan)	4,122,609	2.99
7. Hamish Craig Edwards and Tineke Jane Edwards and Andrew Paul Finch	3,281,095	2.38
8. Credit Suisse Securities (Europe) Limited	1,652,893	1.20
9. Nicola Jane Wilson and David Jonathan Wilson	1,283,258	0.93
10. Nelson Nien Sheng Wang and Pei Chun Ko	1,150,288	0.83
11. UBS Nominees Pty Ltd	1,104,401	0.80
12. Craig Michael Walker and Catherine Claire Walker	770,330	0.56
13. W5 Limited	713,750	0.52
14. JP Morgan Nominees Australia Limited	705,551	0.51
15. Xero Limited (Employee Restricted Share Plan)	633,944	0.46
16. BNP Paribas Nominees Pty Ltd	608,324	0.44
17. National Nominees Limited	581,595	0.42
18. JBWERE (NZ) Nominees Limited	536,053	0.39
19. FNZ Custodians Limited	524,008	0.38
20. Graham John Shaw and Delwyn Joy Shaw	500,000	0.36

Substantial product holders According to notices given under the Financial Markets Conduct Act 2013, the following persons were substantial product holders in Xero Limited at 31 March 2017:

Substantial product holder	Quoted voting products in the Company in which a relevant interest is held
1. Anna Margaret Clare Drury and Rodney Kenneth Drury and Scott Moran (Rod Drury)	20,719,779
2. Givia Pty Limited and Bangarie Investments Pty Limited (Craig Winkler)	17,475,990
3. Matrix Capital Management Company, LLC; Matrix Capital Management Master Fund, LP; and Matrix Capital Management Fund II, LP (Matrix Capital Management)*	13,197,103
4. Valar Ventures LP; Valar Global Principals Fund I LP; Valar Global Fund I LP; and VV Xero Holdings LLC (Peter Thiel)**	7,763,345

**On 30 November 2012, Matrix Capital Management Company, LLC and Matrix Capital Management Master Fund, LP filed a Substantial Security Holder Notice disclosing a total interest of 11,489,934 ordinary shares in Xero Limited. On 16 October 2013, Xero Limited issued a further 991,736 ordinary shares to parties named in the Substantial Security Holder Notice dated 30 November 2012. On 13 March 2015, Xero Limited issued a further 715,433 ordinary shares to Matrix Capital Management Master Fund, LP and Matrix Capital Management Fund II, LP. On 18 April 2017 and on 27 April 2017, Matrix Capital Management Company, LLC and Matrix Capital Management Master Fund, LP filed Substantial Security Holder Notices disclosing a movement of 1% or more in substantial holding and change in the nature of the relevant interest. Pursuant to these notices, at 27 April 2017 the number of quoted voting products in the Company in which a relevant interest was held was 11,767,306*

*** On 6 April 2017, Peter Andreas Thiel filed a Substantial Security Holder Notice disclosing a cessation of substantial holding in the Company*

The total number of issued voting shares in Xero Limited at 31 March 2017 and 28 April 2017 was 137,761,136.

Voting rights Where voting at a meeting of shareholders is by voice or a show of hands, every shareholder present in person, or by representative, has one vote, and on a poll, every shareholder present in person, or by representative, has one vote for each fully paid ordinary share in the Company.

Restricted Securities 633,944 shares were held on a restricted basis in connection with the Company's Employee Restricted Share Plan at 28 April 2017.

Options There were 76 individuals holding a total of 2,188,001 options at 31 March 2017.

Restricted Stock Units (RSUs) There were 278 individuals holding a total of 327,463 RSUs at 31 March 2017. RSUs are a conditional contractual right to be issued an equivalent number of ordinary shares in the Company.

Foreign Exempt Listing (ASX) The Company's ASX admission category is an ASX Foreign Exempt Listing. The Company continues to have a full listing on the NZX Main Board and is primarily regulated by the NZX. The Company's shares are listed on both the NZX Main Board and the ASX. Pursuant to ASX Listing Rule 1.15.3, the Company confirms that it continues to comply with the NZX Listing Rules. Based on the principle of substituted compliance, the Company is exempt from complying with most of the ASX Listing Rules.

Waivers (NZX) In May 2016, NZX Regulation granted the Company a waiver from NZX Listing Rule 5.5.1(b) to allow the Company, subject to certain conditions, to hold its 2016 Annual Meeting outside of New Zealand. The Company relied on this waiver during the financial year ended 31 March 2017.

In July 2014, NZX Regulation granted the Company a waiver from certain NZX Listing Rules to enable the Board to grant options as remuneration for Directors, subject to the condition that the terms of the options be approved by shareholders. At the Company's 2016 Annual Meeting, it relied on this waiver to obtain approval from shareholders with respect to the granting of options to Chris Liddell and Bill Veghte, which was intended to take place in or around February 2017. Due to the subsequent decision by the Board to remunerate Directors by way of cash or shares, no grant of options to Directors took place during the year ended 31 March 2017.

Waivers (ASX) Xero has also been granted waivers from the ASX which are standard for a New Zealand company listed on the ASX including confirmation that ASX will accept financial statements denominated in New Zealand Dollars and prepared and audited in accordance with New Zealand Generally Accepted Accounting Principles and Auditing Standards.

Donations The Company made no donations during the year ended 31 March 2017.

Company subsidiaries The Company has seven wholly-owned subsidiaries, consisting of a wholly-owned operating subsidiary in each of the Company's four core markets (being Australia, New Zealand, the United Kingdom, and the U.S.); Monchilla, Inc. (acquired by the Company in November 2014); Xero (Singapore) Pte. Ltd. (incorporated on 24 March 2016); and a wholly-owned subsidiary that acts as trustee in relation to one of the Company's share schemes.

Subsidiary company Directors The following people held office as Directors of subsidiary companies at 31 March 2017:

Xero (UK) Limited – Rod Drury, Gary Turner
Xero Australia Pty Limited – Rod Drury, Trent Innes
Xero (NZ) Limited – Rod Drury, Anna Curzon
Xero, Inc. – Rod Drury
Xero Trustee Limited – Rod Drury
Monchilla, Inc. – Rod Drury
Xero (Singapore) Pte. Ltd. – Rod Drury, Alex Campbell

Andy Lark resigned as a Director of Xero (Singapore) Pte. Ltd. effective 30 October 2016.

No Director of a subsidiary receives or retains any remuneration or other benefits from the Company for acting as such.

Annual Meeting Xero's 2017 Annual Meeting will be held on Wednesday, 12 July 2017 at 9am AEST (11am NZT) at Level 3, Establishment, 252 George Street, Sydney, NSW, Australia, and virtually through an online platform provided by the Company's share registrar, Link Market Services.

'The Trent' // Managing Director AUS

Corporate Directory

REGISTERED OFFICES:

NEW ZEALAND

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WELLINGTON 6011
NEW ZEALAND

TELEPHONE: +64 4 819 4800
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AUSTRALIA

1/6 ELIZABETH STREET
HAWTHORN, VIC 3122
AUSTRALIA

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COMPANY NUMBERS:

183 0488 NEW ZEALAND

160 661 183 AUSTRALIAN
REGISTERED BODY NUMBER
(ARBN)

WEB ADDRESS:

WWW.XERO.COM

DIRECTORS:

GRAHAM SMITH
CHAIR

ROD DRURY

CRAIG ELLIOTT

LEE HATTON

SUSAN PETERSON

BILL VEGHTE

CRAIG WINKLER

LEADERSHIP TEAM:

ROD DRURY
(CHIEF EXECUTIVE, CO-FOUNDER)

SANKAR NARAYAN
(CHIEF OPERATING AND FINANCIAL OFFICER)

DUNCAN RITCHIE
(CHIEF PRODUCT AND PLATFORM OFFICER)

ANNA CURZON
(CHIEF PARTNER OFFICER)

TONY STEWART
(CHIEF DATA OFFICER)

RACHAEL POWELL
(CHIEF PEOPLE OFFICER)

KIRSTY GODFREY-BILLY
(CHIEF ACCOUNTING OFFICER)

KERI GOHMAN
(PRESIDENT AMERICAS)

TRENT INNES
(MANAGING DIRECTOR, AUS)

GARY TURNER
(MANAGING DIRECTOR, UK)

CRAIG HUDSON
(NZ COUNTRY MANAGER)

ALEX CAMPBELL
(MANAGING DIRECTOR, SG)

COMPANY SECRETARY:
CHAMAN SIDHU

AUDITOR:

EY

STOCK EXCHANGES:

THE COMPANY'S ORDINARY SHARES ARE LISTED ON THE NZX MAIN BOARD AND THE ASX

SHARE REGISTRAR:

NEW ZEALAND

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80 QUEEN STREET
AUCKLAND 1010

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AUSTRALIA

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SYDNEY SOUTH, NSW 1235

TELEPHONE: +61 1300 554 474
FACSIMILE: +61 2 9287 0303

ANNUAL MEETING:

DATE: 12 JULY 2017
TIME: 9AM (AEST), 11AM (NZT)
LOCATION: SYDNEY, AUSTRALIA